DOCUMENT RESUME

ED 363 187 HE 026 797

TITLE	Student Loan Reform. Hearing on S. 920 of the Committee on Labor and Human Resources, United States Senate, One Hundred Third Congress, First Session.
INSTITUTION	Congress of the U.S., Washington, D.C. Senate Committee on Labor and Human Resources.
REPORT NO	ISBN-0-16-041465-2; Senate-Hrg-103-188
PUB DATE	26 May 93
NOTE	181p.
AVAILABLE FROM	U.S. Government Printing Office, Congressional Sales Office, Washington, DC 20402.
PUB TYPE	Legal/Legislative/Regulatory Materials (090)
EDRS PRICE	MF01/PC08 Plus Postage.
DESCRIPTORS	Access to Education; *Educational Change; Educational Finance; Educational Legislation; Federal Aid; *Federal Legislation; Federal Programs; Government Role; Hearings; Higher Education; *Student Financial Aid; *Student Loan Programs
IDENTIFIERS	Congress 103rd; *Direct Vending; Proposed Legislation; Stafford Student Loan Program

ABSTRACT

The Senate Committee on Labor and Human Resources met to consider an amendment to the Higher Education Act of 1965 to improve the delivery of college financial aid by moving from guaranteed students loans to direct loans. Under a system of direct loans, students would borrow directly from the Federal Government by applying through their colleges. Senators who offered opening statements on the proposed legislation were Senators Durenberger, Kassebaum, Pell, Jeffords, Metzenbaum, Hatch, Simon, Dodd, Coats, Wellstone, Gregg, Kennedy, Mikulski, and Thurmond. Proponents of the change noted increased access to loans, budget savings, and system simplification. Opponents cited the difficulty of change, the difficulty of knowing exactly the consequences of a new system, risks to the government, and costs of administration. The Committee also heard from a panel led by Madeleine Kunin, Deputy Secretary of the Department of Education presenting the Administration plan and answering questions on details of the plan. In addition a group of college presidents, university administrators, and students appeared to offer their views on proposed changes. Finally a large number higher education leaders of associations and financial aid groups appeared to offer their testimony on the legislation. Additional materials appended includes articles, publications, reports, and correspondence. (JB)

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S. Hrg. 103-188

STUDENT LOAN REFORM

HEARING

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

ON

S. 920

TO AMEND THE HIGHER EDUCATION ACT OF 1965 TO SIMPLIFY THE DELIVERY OF STUDENT LOANS TO BORROWERS AND ELIMINATE BORROWER CONFUSION; TO PROVIDE A VARIETY OF REPAYMENT PLANS, INCLUDING INCOME CONTINGENT REPAYMENT THROUGH THE EXCEL ACCOUNT, TO BORROWERS SO THAT THEY HAVE FLEXIBILITY IN MANAGING THEIR STUDENT LOAN REPAYMENT OBLIGATIONS, AND SO THAT THOSE OBLIGATIONS DO NOT FORECLOSE COMMUNITY SERVICE-ORIENTED CAREER CHOICES FOR THOSE BORROWERS; TO REPLACE, THROUGH AN ORDERLY TRANSITION, THE FEDERAL FAMILY EDUCATION LOAN PROGRAM WITH THE FEDERAL DIRECT STUDENT LOAN PROGRAM; TO AVOID THE UNNECESSARY COST, TO TAXPAYERS AND BORROWERS, AND ADMINISTRATIVE COMPLEXITY ASSOCIATED WITH THE FEDERAL FAMILY EDUCATION LOAN PROGRAM THROUGH THE USE OF A DIRECT STUDENT LOAN PROGRAM, AND FOR OTHER PURPOSES.

MAY 26, 1993

Printed for the use of the Committee on Labor and Human Resources

U.S. GOVERNMENT PRINTING OFFICE
68-494cc WASHINGTON : 1993

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-041465-2

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STUDENT LOAN REFORM

WEDNESDAY, MAY 26, 1993

U.S. SENATE,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 10:00 a.m., in room SD-430, Dirksen Senate Office Building, Senator Edward M. Kennedy (chairman of the committee) presiding.

Present: Senators Kennedy, Pell, Metzenbaum, Dodd, Simon, Wellstone, Kassebaum, Jeffords, Coats, Gregg, Hatch, and Durenberger.

OPENING STATEMENT OF SENATOR KENNEDY

The CHAIRMAN. We'll come to order.

In today's hearing, we will consider a long overdue improvement in college aid: moving from the current system of guaranteed student loans to direct loans. We made many improvements to the current loan program in last year's Higher Education Act. Now, under the leadership of President Clinton, we have the opportunity to take even bolder steps to reform the program and make it serve students more effectively.

Under the current system, college students borrow for their education by obtaining bank loans from the private sector. These loans are guaranteed, and heavily subsidized by, the Federal Government. Under a system of direct loans, students will borrow directly from the Federal Government by applying through their colleges.

Direct lending is an all-around winner. It is a win for students and their families, a win for colleges, a win for taxpayers, and a win for the public interest against special interests. Direct lending is the only education proposal currently under consideration by Congress that allows us to achieve major budget savings and make the program better for students.

President Clinton has made it clear that the administration strongly supports the move to direct lending, and many of us in Congress support it as well.

Congress is already solidly on record in support of this principle. In the Higher Education Act last year, we took the first major step toward this reform by approving a large pilot program, with the goal of moving as rapidly as possible to a system of direct loans. I have supported this idea for many years. Working with President John Silber of Boston University, I introduced legislation in 1978 to combine direct Federal lending and income-contingent repayment. We had impressive bipartisan support for that proposal.

Partly because of the unrealistic budget accounting method used at that time, Congress chose not to go forward with the idea.

Now, the growing problems and costs of the Guaranteed Student Loan Program have generated new interest in direct lending. The budget accounting problem is resolved. It is an idea whose time finally seems to have come.

A direct loan system will produce important benefits. First, it will save substantial amounts over the current program—$2 billion a year when finally implemented—and enable us to pass these savings on to students. The savings to students are generated in two ways—by reducing the interest rates and origination fee they pay on their college loans.

The current system of guaranteed loans unwisely gives large profits to the bank as middlemen, while the taxpayers bear virtually all of the risks. There is no reason why the Federal taxpayer should be subsidizing a system that makes student loans more profitable for banks than auto loans and home mortgages.

Students will have as much access to direct loans as they have under the current system. Available funds will not be limited by congressional appropriations. Direct loans will be an entitlement for students as are the current guaranteed loans.

Under a companion feature of the direct lending bill called "income-contingent repayment," students may elect to repay their loans as a percentage of their earnings. In this way, they can more easily pursue lower-paying careers of their choice instead of being forced by their college debts to enter high-paying professions. No college student should be forced to become a lawyer or investment banker who would rather be a teacher.

In addition, a direct loan system will simplify the current complex process for students and colleges. A direct loan program will have fewer middlemen and be easier to manage than the existing loan program.

Just as there are reasons to move in this direction, there are reasons to move with care. Under no circumstances must we permit the implementation of the direct loan program to interrupt the flow of loans to students. Any transition to direct loans must take place smoothly and efficiently.

President Clinton's proposal includes a 4-year phase-in for the direct loan program. During this period, we will be able to assess the ability of the Department of Education and the Nation's colleges to administer the loans.

Many of us feel that the biggest hurdle to this worthwhile reform has already been overcome—we have an administration committed to making it work. As the phase-in proceeds, we will have ample opportunity to make mid-course corrections, or even delay the final implementation date if more time is needed.

Tuition costs have been rising much more rapidly than family incomes. It is more important than ever to make college education affordable and accessible to every American.

Direct loans have the potential to be one of the most worthwhile reforms enacted in Federal aid to education. The administration deserves a chance to demonstrate that it can work and work well for the benefit of students and colleges, at a much lower cost to the Federal Government.

We will hear today from the Deputy Secretary of Education, Madeleine Kunin, and other distinguished witnesses representing all points of view on this important legislation. I am grateful to each of them for joining us, and I look forward to hearing their testimony.

Senator Kassebaum.

OPENING STATEMENT OF SENATOR KASSEBAUM

Senator KASSEBAUM. Thank you, Mr. Chairman.

I welcome the opportunity this morning to explore in greater depth the administration's direct lending proposal. I know it is no surprise that I have been very skeptical for some time about exactly how well the program would work and I have some serious misgivings.

Throughout the debate over direct lending, a number of important questions have been raised, none of which have really been answered to my satisfaction.

I certainly share with you, Mr. Chairman, the concern about the escalating cost of tuition; I think we all share that concern. But I know there are a number of members, on both sides of the aisle who share my unease, and I would just like to specifically mention several of the concerns I have had.

One is whether direct lending will actually produce savings to the Federal Government? Estimates are all over the lot on that, leading one to the conclusion that no one really knows. OMB and CBO have widely differing views, about a $3 billion difference in their estimates. Coupled with the fact that average administrative costs for direct loan programs far exceed those for guaranteed loan programs, and that Government contractors don't work for free, there are legitimate grounds, for questioning what savings there would be.

Will the Department of Education be able to manage the massive new responsibilities they will be assuming? I have enormous respect for the Deputy Secretary and for the Secretary, but in a very short period of time, the Department would be overseeing a dramatic transformation of what is now a $15 billion a year enterprise. I understand that 600 additional people will have to be brought on to handle the program. This is a lot of change to manage, particularly when the Department must also administer the very important efforts to improve integrity which were included in last year's higher education reauthorization.

Third, will the program really help students? The fact of the matter is that the savings that are supposed to be achieved are not being passed on to students; they are going to the Government. That is projected in the budget resolution as a savings for the Government. In the meantime, the great potential for disruption of loan programs can result in some great uncertainty and perhaps even harmful consequences for students.

Fourth, will the program be simpler? We could all wish so. But that remains to be seen. We have to recognize that this program is structured in a way that, while the names may change, many of the players in the program will remain the same. From a student's point of view, it is difficult to imagine that having to deal directly with the Department of Education or the Internal Revenue Service will be simpler.

Fifth, why do we not seek to achieve the objectives of direct lending through revisions of the current program? To the extent that excess profits are a problem, we can achieve savings by recapturing those excesses. To the extent that we want to help students, we can pass those savings directly on to them. If the goal is simplification, that can be achieved both by squeezing out less efficient operations and by building upon the simplification measures enacted last year.

Sixth, finally, why not try out the concept before we launch a full-blown program? A demonstration program has already been devised and is ready for implementation next year. It is astonishing that we would consider making such fundamental changes without first having tried them out.

Mr. Chairman, these are basic questions, and I think it is absolutely essential that we explore them with the honesty that I know we all bring to this issue, because the failure to answer them adds up to a high-risk strategy, with the accessibility of student loans on the line.

I would just add, Mr. Chairman, that this battle, if we want to call it a battle, has been portrayed as one of greedy bankers versus American students, and I think that misses the point entirely. I believe as well that it is a disservice to suggest that the hundreds of financial aid officers and institutions of higher education that have expressed some concerns and uncertainty about this have been "brainwashed" into that position by legions of high-priced lobbyists. These are people who have worked with this program and with the Department of Education for years. Their bottom line and mine is assuring that the student loan programs works well for the individuals they were designed to serve, and that is the students.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Kassebaum.

Senator Pell.

OPENING STATEMENT OF SENATOR PELL

Senator PELL. Thank you, Mr. Chairman.

I want to thank you for calling this hearing on direct loans. It is an important hearing on a very important subject.

From the outset, I'd like to make it clear that I strongly applaud and endorse the administration's desire to reform the student loan program. In requiring approximately $4.6 billion in savings as a part of the budget resolution, it would seem to me that President Clinton has already scored a major victory. Student loan reform is on the way. The only remaining question is how we go about achieving those savings.

As you know, Mr. Chairman, I have real reservations about moving to a direct loan program without first testing the concept. We have a demonstration program on the books, and my own preference would be to learn from that demonstration before we move into uncharted waters.

I have long thought the best approach is to access private capital, using the private market, and not increase the national debt through borrowing to finance a direct loan program.

I continue to have concerns over the ability of the Department and many colleges to manage a program of this magnitude. I have heard from a number of financial aid administrators and associations over the past several weeks. Almost all have expressed deep reservations about going beyond the pilot program at this time. Yet these are the very people we will depend upon to administer the direct loan program. Perhaps we should consider their viewpoint very, very carefully before moving forward.

But most of all, we cannot and should not move from one program to another until we are sure we have all the safeguards in place to protect student accessibility to loans. Students and families cannot be put at risk.

I would also add that I strongly support the President's proposal for an income-contingent loan program. Its inclusion as another option for students to choose in repaying their loans is an excellent idea. It will help reduce defaults, and could also help encourage students to enter public service occupations which often, and unfortunately, do not carry high salaries.

Mr. Chairman, I look forward to this hearing and to the exchange of ideas. I continue to have an open mind to the President's proposal, and would ask unanimous consent that an editorial that appeared in The Washington Post on Saturday be inserted in the record at this point.

The CHAIRMAN. It will be so included.

[Editorial follows:]

[FROM THE WASHINGTON POST—SATURDAY, MAY 22, 1993]

GO DIRECTLY TO UNCLE SAM?

Students who borrow money for college usually get if from the banks. The Clinton administration wants them to go directly to the Federal Government instead. Direct lending, which substitutes Federal borrowing for private capital, is supposed to save a lot of money. It will if the projections and assumptions of the budget estimators are right. The banks claim otherwise. Direct lending also might help in other ways, by giving the government more control over the terms of repayment.

Proponents of direct loans like to compare charts. One is a tangle of lines purporting to show how loan money flows among students, colleges, banks, guarantee agencies, secondary markets and the Department of Education. It's a good representation of the confusion, inefficiency and complexity that have come to be associated with the subsidized loan program, which provides billions of dollars to private lenders who profit handsomely.

The other chart has easy-to-follow lines, with money flowing from the Federal Government to the colleges and hence to the students and back again to the U.S. Treasury. The graphic bolsters the rationale for direct loans—namely, that such a system would be simpler and more user-friendly.

In theory, direct loans would be cheaper as well—not only for students but eventually for all taxpayers. By cutting out the middlemen—that is, the banks and numerous other agencies that buy and service loans—the government would save money it now spends on interest subsidies, fees and guarantees. Direct loans would enable students to choose among more flexible repayment options, which the profit-oriented lenders don't offer, and such flexibility would cut down on costly defaults. President Clinton is banking on an estimated savings of $4.3 billion in the first 5 years of the program and $2 billion a year after that.

How firm are the numbers? No one knows, because direct lending has never been attempted on a large scale. The Higher Education Act of last year authorized a pilot, which has yet to be implemented. Why not wait for the results? The administration argues that its program is nothing more than a careful, incremental expansion of the pilot over 4 years. But the consequences—some of them unanticipated—must be monitored:

(1) How much of the cost would shift to colleges, which would originate loans or arrange for others to do so? The government is offering to pay the schools an origination fee, but the colleges worry that it isn't enough.

(2) Would loan funds be delayed if the debt ceiling weren't raised? The loan program would remain an entitlement, but it wouldn't necessarily remain free of political pressure to curb the debt.

(3) Finally, is the Department of Education, which has a poor reputation for managing the guaranteed loan program, capable of handling $100 billion in loans that would accrue after 4 years?

Congress is moving quickly to consider a direct-lending program, despite vociferous opposition from the banks. Whether such a system works as cleanly and neatly as those lines on the chart, however, is something the Department of Education still has to prove.

The CHAIRMAN. Senator Jeffords.

OPENING STATEMENT OF SENATOR JEFFORDS

Senator JEFFORDS. Mr. Chairman, I am going to take basically the same line that the chairman of the subcommittee on education does as well as my ranking member.

I support direct lending. However, I am deeply concerned that this is only the second and last hearing that we will have to discuss the issue of direct lending. As we all know, direct lending fundamentally changes our current system of delivery for student financial assistance. A change of this magnitude affects the 4 million current student borrowers and countless new borrowers. It is not a change that we should take lightly. Nor is it a change that we should undertake as part of the budget process—agreeing to a concept before seeing legislative language.

Public policy should not be driven solely by the need to save money. It should be undertaken thoughtfully and carefully. I do not believe that moving full force ahead into uncharted waters, without knowing whether the delivery system will work or not, is wise public policy.

It is true that I oppose moving to immediate full implementation of direct lending, but I do so not because I wish to protect the current players in the program, but because I think we need to fully examine a program of this magnitude before we make drastic changes.

For the record, let me be clear where I stand. Here is what I do support. I support whatever is best for the student. We must never lose sight of the beneficiaries of the program. The students and their interests must come first.

Next, I do not have a philosophical problem with direct lending as an alternative to the current delivery system for student financial assistance. Further, I do not oppose increasing the size of the present demonstration program. We should.

I also do not oppose streamlining the current program, nor do I oppose reducing the excessive incentives currently being paid to lenders, guarantors, and secondary markets. In fact, I tried to drastically reduce the special allowance paid to lenders during last year's reauthorization of the Higher Education Act. Unfortunately, I was unable to get a majority of this committee to support that effort.

I support allowing partial repayment by participation in national service. And finally, I support the concept of income-contingent repayment if it is offered as an option to students.

Now let me tell you what I do not support. I believe we are at a unique juncture in time. We have in place a pilot program ready to test the feasibility of implementing a system of direct lending. Direct lending may very well be the wave of the future for the student loan delivery system. My fear, however, is that we are considering jumping into direct lending too quickly. If this new system should backfire because of its delivery system problems, we risk more than just embarrassment—we risk creating problems for over 4 million students receiving their loans. It is for that reason that I oppose immediate fully implementation of direct lending at this time.

I understand that the reconciliation package proposes a phase-in of direct lending. However, the phase-in period is much different than the one envisioned in the pilot program included in the Higher Education Act Amendments. That pilot program called for a true test of the feasibility of moving to direct lending by requiring that a broad cross-section of schools including such things as length of academic program, degree offered, size, annual loan volume, default experience and geographic location would be considered.

Unfortunately, those stipulations are no longer a requirement of the administration's phase-in program. Instead, the administration's plan strikes those requirements and calls for only those schools that are capable of participating. These institutions will not give us an accurate understanding of the feasibility of moving to full implementation.

Furthermore, the goal is full implementation in 3 years. That is not a demonstration program or a responsible length of time. In fact, under that scenario, turning back will be much more difficult than if we begin more cautiously at the beginning and ascertain where the problems are and what changes we should make.

I am also skeptical of the savings estimated from moving to the implementation of direct lending. In January 1992, CBO put out a study comparing the administrative costs associated with direct loans and those associated with guaranteed loans. Two things were evident from that study.

The first is that the Government incurs 8 percent of the administrative costs under a direct loan program whereas they incur only 2 percent under guaranteed student loans.

The second is that the administration costs under direct lending are not scored on a present-value basis. As such, the direct lending program appears to save more money than it actually does.

Let me quote a portion of this report: "Advocates of replacing loan guarantees with direct loans claim that savings will come from reducing the special allowance paid to lenders. However, this claim overstates the savings from a direct loan program since a direct loan program would also have administrative costs. Even if the administrative costs of the direct loan program were taken into account, current accounting and budget scorekeeping would understate total costs of direct loans relative to the existing loan guarantees program."

We must move very cautiously into a program that not only must borrow over $16 billion a year, but in which the administrative costs represent a huge unknown.

I also do not believe that this proposal will necessarily make things simpler for students. As far as the students are concerned, they will still have to apply for a loan, co-sign the note and repay that loan to some entity other than the institution that they attended. Furthermore, I know in my own State of Vermont and in countless other States, that students deal with just one entity other than their own institution. Our State guarantee agency serves as lender, guarantor and secondary market. When a student has a problem with a repayment, they call one number, or visit one agency. I strongly disagree that a 1-800 number at the Department of Education will better serve the students of Vermont.

Furthermore, I question that hiring 600 new employees at the Department of Education saves money. I understand that the Office of Postsecondary Education has already requested 600 new employees to administer the direct lending program. This request comes at a time when the President is asking that Federal agencies cut excess costs. It just doesn't seem to make sense.

Finally, I cannot ignore the pleas of countless individual student financial aid administrators, 26 State financial aid associations, and five regional groups and the National Association of Student Financial Aid Administrators that have asked that the pilot be fully developed and tested before moving into full implementation of direct lending. These individuals do have a "special interest" in mind—the students. Financial aid administrators have experience in these programs. We should listen to their concerns.

The current program needs to be fixed—there is no doubt about that—my only concern is that we are moving too rapidly to a program which I feel will be an answer, after we have examined it to make sure that it runs smoothly and will not backfire.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Jeffords.

Senator Metzenbaum.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator METZENBAUM. Mr. Chairman, I am happy to join you and others in welcoming Governor Kunin to the hearing today as well as the other distinguished witnesses.

This hearing has attracted a lot of attention and concern. I would like to commend my colleague from Illinois, Paul Simon, for being a leader in this area over a period of time. He was out front early on, saying that there is a lot of waste, a lot of unnecessary spending, tremendous salaries being paid to those who administer the program at the student loan administration, and he has brought the issue to the fore.

Now, the President of the United States has picked up the ball and run with it, and with the Department of Education, they are certainly moving forward on this area, and I think that we ought to move forward ourselves, because if there can be savings effected, we ought to bring them about.

I am pleased that this legislation has done so much for the economy already. The number of lobbyists who have been employed against this legislation is certainly a great stimulant to the economy and will undoubtedly increase the gross national product of this country, or else the earnings of some of the lobbyists. But some part of the lobbying is very disturbing to me, and that is the part where those who are involved in this effort to preserve the present way have used students, paid for their advertising in Ohio papers, and used them as a front in order to engender support to oppose this proposal.

The fact that nobody knew who paid for those ads until some investigative work was done, and then it was found that those who were directly involved were really providing the funds for the students, to me was really a despicable kind of operation—first of all, despicable in not making it clear to the readers of those ads who was paying for them, that it was those who have direct financial interest; but second, it was despicable as I see it in using young people to be the front in this effort.

One of those young people was in my office yesterday, and I made it very clear to him that I thought this was totally inappropriate and hardly the way for a young person to get started in a way of life, that is, to be used by someone else. I don't blame him as much as I blame those who are involved in trying to preserve the present system.

Then I found that in Ohio, the operation is run by a nonprofit corporation. The chairman of the board of that group was in my office, and I asked him some questions about what they were spending on this, and who was paid what, and some other specific questions. And I found that the chairman of the board—who is unquestionable an inestimable human being, a fine person, a former president of Ohio College—really didn't know much about what was going on in this nonprofit corporation of which he was the chairman.

So I say, then, when dealing with an issue that is of so much concern to young people throughout the country, student loans, and the young people who will be coming up needing those student loans in the future, I am aghast and disturbed and upset about the efforts and the tactics that have been used by those who are opposing any change.

Again, I commend my colleague Paul Simon for his leadership in this area and look forward to the testimony today.

The CHAIRMAN. Thank you, Senator Metzenbaum.

Senator Hatch.

OPENING STATEMENT OF SENATOR HATCH

Senator HATCH. Thank you, Mr. Chairman.

Welcome, Governor Kunin. I appreciate having you here and look forward to reading your testimony.

I welcome this hearing today on the subject of the direct spending program in lieu of our current system of student financial aid. Perhaps we can find out just how tenuous this particular concept really is.

I hope that Congress can resist the rare opportunity to maximize disruption for at least four distinct groups of people and organizations all at the same time, with just one proposal. I suppose in its own way, that is being economical.

Kidding aside, I urge the committee to defer action on this proposal indefinitely, until we know with more certainty what the real effects of direct lending will be. We do no service to students, colleges, universities, lending institutions or student loan agencies by moving ahead with legislation that is based on claims of budget savings that have not been substantiated.

As our ranking member has said, thus far we have had at least three different estimates of budget savings from the Congressional Budget Office and the Office of Management and Budget, and there is a $3 billion difference between the highest and the lowest estimates. Moreover, we have a report from the Congressional Research Service, a study by former CBO Director Rudolph Penner, for Peat Marwick, and an analysis by Ernst & Young that question whether we will achieve any real savings after the transactional and administrative costs have been taken into account.

It is quite conceivable that direct lending could actually cost additional moneys to the budget. In fact, I believe in the end it will prove to do exactly that.

Mr. Chairman, the dubious budget savings of direct lending is only one reason to shelve this proposal. Another reason of equal importance is the fact that our student loan program, which has been operating successfully for many years, will be completely revamped. Let us not underestimate the effect this will have on colleges and universities and on students themselves. We will be sanctioning utter chaos in the student loan program, and we would be sanctioning it without the results of the pilot program we authorized in the Higher Education Act reauthorization just last year.

Mr. Chairman, I have heard from almost every institution of higher education in Utah. Without exception, they have urged this committee to reevaluate the benefits of direct lending. These institutions in Utah are not opposed to change, Mr. Chairman, and they understand the need to find real savings in the student loan program. But I strongly support their reticence to dump a system that has worked well and on which thousands of Utah students rely without fully understanding the consequences of this direct lending alternative.

So Mr. Chairman, I am very concerned about it, and I hope we can find some way of resolving these problems without getting us into deeper trouble.

Thank you.

The CHAIRMAN. Senator Dodd.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. Thank you, Mr. Chairman.

I too want to commend you for holding these hearings and welcome our witnesses—Governor Kunin, it is a pleasure to have you with us—and to also join in commending our colleague from Illinois and others whom I know have been involved in this. I know Dave Durenberger has also had an interest as well as several members of the House who have worked on this and been concerned about it for a number of years.

Mr. Chairman, there are many areas of Federal law that are complex, and that is not saying anything new to anyone in this room this morning, and many proposals where we wrestle with very difficult technicalities. But unlike most other areas of Federal law, technical issues in this particular case I believe are central to this discussion and are to a great extent driving the debate.

Whether this program succeeds or fails, and whether students have their checks in hand or not when school begins, will ultimately rest on the details of the proposal adopted by the Congress in the next several weeks.

This issue is not new to this committee or to the Congress. It is one that my colleague from Illinois and others have worked on for a long time. Most recently, of course, we had extensive debate on the matter as part of last year's reauthorization of the Higher Education Act. At that time, along with many of my colleagues on this committee, we expressed some hesitancy to proceed to a full-scale direct loan program. Those hesitancies were increased by the Bush administration's strong opposition, as we will all recall, to the direct loan program.

But this is a new day in our city and in this country. We have a new President who is fundamentally committed to education and fundamentally committed to the idea of direct loans. That means a great deal to this Senator and to this committee and to the Senate as a whole. The level of commitment is expressed by what I think is a thoughtful effort that has gone into the bill before us, and while I have some personal concerns about the aspects of the plan that are not outlined in the legislation—and that is what concerns me—I consider the amount of work that has gone into the measure a clear indictor of the level of energy the administration is willing to put into making this program work.

But work, energy and commitment alone will not make a program work. We must look at the current student aid delivery system and see what works and expand upon those successes. We must also determine what doesn't work and correct those failures. We know that the complexity of the current loan program is a friend to no one, particularly those students for whom this program is designed. We can't be afraid of change. Today's system, which relies to a significant degree on the private sector, delivers student aid effectively; there is no question about that in this Senator's mind. It reaches students, families and institutions of every size and in every community in this country. Yet few understand it, and the costs to the Federal Government are extremely high, as are the profits to some of those in the private sector who participate.

Reform is clearly needed as well as mandated by the budget resolution. I know that Senator Jeffords raised this issue, Mr. Chairman, but we are under a reconciliation order that by June 18th we have got to come up with $4.3 billion in savings in this particular area. And whether you do it by radically changing the present system or going to a direct loan program, we have got to come up with $4.3 billion in less than a month in this particular areas. Those are our instructions, so we've got a sizeable task in front of us in a very short amount of time, but it has to be done. So we have got to look very carefully at these alternatives.

Ultimately, there is only one question that has to be answered in order to determine whether we should go in the direction proposed by the President; that is the question of whether this program will benefit students. That is what all of us care about. If we can answer that question affirmatively, then I believe it deserves our full and strong support.

So Mr. Chairman, I look forward to the hearing this morning and to the witnesses as they go into this area, but I want to stress that I think the technicalities are central to this debate and should not be overlooked, nor should the Congress be denied an opportunity to be involved and engaged in that discussion and debate, and merely left to the administration to resolve.

So I thank you for the hearing.

The CHAIRMAN. Thank you, Senator Dodd.

Senator Durenberger.

OPENING STATEMENT OF SENATOR DURENBERGER

Senator DURENBERGER. Mr. Chairman, thank you. I have a statement that I would appreciate being made part of the record.

The CHAIRMAN. It will be made part of the record.

Senator DURENBERGER. I also want to introduce John Schullo, who is here today. John is at the end of the witness list, so I will be here all morning, waiting for John's testimony, and I hope everyone else stays for it as well.

To try to summarize my points so we can go as quickly as possible to the Secretary, I have been here in the Senate for 15 years, serving part of that time on this committee and all of that time on the Finance Committee, and I think every year we have dealt with financing access to education and particularly to higher education. And I just must say that all of the words about caution, I have heard for 15 straight years.

I don't know a more cautious public policy area that I have been in since I have been here. Everybody says don't do this, don't do that, wait, wait, wait, demonstrate, demonstrate, demonstrate, go slow, go slow, be careful—15 years, and we are nowhere, except we have fewer Americans able to make a choice about how and where they are going to get their higher education. And that compels me to be a part of supporting the President and supporting the idea that Paul and I and many others have been working on now for a couple of years to give credit to others more appropriate than the two of us; certainly, we just came along in the last year or so and give it voice, but there are many others here on this committee, in the House of Representatives, and out there in America.

I keep struggling with how to express this whole thing differently, particularly to my Republican colleagues who seem to think we are switching from a private program to a public program. I want them so desperately to believe that no matter how you look at this, it is basically a public program. You can't say that just because you have banks in this system that there is no risk for the banks; if somehow or other the public sector has protected them from any risk at all so they are simply financial intermediaries in the process, then it is a private system.

What we are talking about here basically is increasing the productivity and the efficiency of a public system and how best to do that. If this whole process of financing access could be done totally in the private sector, it would be done in the private sector, but it is not being done in the private sector.

So in struggling to try to present it differently—and I know this is subject to criticism—but when I think about it in terms of my sons, who are now too old to benefit if you are just talking about the natural progression as opposed to the folks we really want to get at and also the nontraditional students, a 16-year-old in America today getting his or her first job will pay the first 15 cents of every dollar they earn into something they don't believe they will ever see, called the Social Security system. Part of it is for Medicare, and part of it is for Social Security. But the first 15 cents on every dollar they earn, wherever they are working, is for a system that can't benefit them for 50 years. That is the way we have set it up in America. You start paying now, and it will be there for you when you are 65 years of age, and then the services are available as they are.

We have in this program the flip side of that. In other words, when you are 16, 17, 18, 30, 40, whenever you make the choice to do it, the service is available to you, the public service, to satisfy your particular needs, the educational service. And then, after you have availed yourself of the service, then you begin to pay. Unlike health care, where the healthy person is going to pay the same stuff in and get relatively little out, and the sick person pays the same in but takes a lot out, in this program, you can kind of decide how much you are going to be paying back into the system, in a variety of ways. In total dollars, at least the way this one is structured, you pay about the same amount in. But the rate at which you pay it back is going to depend on how serious you are about your education, as the chairman said earlier, where you want to put your professional commitment in this society—do you want to be in a big city, in a rural area, in a high-paying job, low-paying, high satisfaction, low satisfaction, whatever the case may be. And to me, that is all we are talking about here. We aren't talking about taking something from the banks and giving it to the Government. We are talking about the way in which young people and people generally in America today can have the security they need of access to higher education and how they are going to pay for it. They will pay for it after the fact instead of paying for it ahead of the fact as we do with the health and medical system.

Now, that may not satisfy anybody as a way to think about this, but I think all of us keep struggling with how to explain it to some of the objectors in a way that will add some meaning to what we are recommending here.

Thank you, Mr. Chairman.

[The prepared statement of Senator Durenberger follows:]

PREPARED STATEMENT OF SENATOR DURENBERGER

Mr. Chairman, before we begin I would like to commend you for your leadership and commitment to working for true reform of America's education system. I also would like to commend the Administration for its dedication to education reform.

The "Goals 2000: Educate America Act" represents a bold and constructive step forward in recognizing the inextricable link between education, job skills, and workplace training.

The portion of that education reform bill we are considering today creates a "National Skill Standards Board," which will help to develop a voluntary national system of worker "skill standards" that can be used:

—by employers, to help them evaluate prospective employees and to train their workers;

—by students and workers, to determine the skills they need in order to compete for high-skill, high wage jobs; and

—by educators, to develop training programs that will prepare America's students and workers for the competitive challenges they will face as we enter the New American Century.

believe that the Federal Government can play an important role In developing and promoting national occupational skill standards. The Federal Government can help provide a national framework for developing standards. It can provide some financial assistance to small and medium-sized companies interested in training their workers. It can provide Information, expertise, and technical assistance. It can help avoid unproductive and duplicative efforts. And it can act as a facilitator, a disseminator of information, and, to some extent, a partner with American business, workers, students, and educators in developing and implementing skill standards.

But the Federal Government cannot—and should not—take the lead in this effort. For skill standards to play a valuable role in helping America to compete into the year 2000 and beyond, the effort must be made Instead at the local level by the private sector, as well as communities, students, teachers, workers, and State and local government.

Mr. Chairman, the "purposes" section of this bill declares that the skill standards framework set forth in Title IV will serve as a "cornerstone" of our "national strategy" to enhance workforce skills. do not disagree with the essence of that statement, but I do disagree with its emphasis.

The foundation on which America's ability to compete ultimately rests will not be constructed here In Washington. Instead, it will rise or fall on the back of the American construction worker, and on the skills and ambition of the pipefitter, the auto worker, the secretary, and the schoolteacher.

That foundation cannot be developed In this hearing room or on the floor of the United States Senate. It will be built instead in America's boardrooms, communities, and factories.

Further, if skill standards are going to work, I believe that it is absolutely critical for industry to play the leading role in developing these standards. Without exception, each and every witness at our hearing May 14 who addressed this point emphasized that industry must take the lead in developing occupational standards.

There must be a place at the table for all interested parties—labor unions, workers, students, businesses, communities, State and local governments, and educators. All these stakeholders must work together if America is to thrive. But it is American industry that must make employment decisions and training decisions based on these occupational standards, and it is America's businesses that must compete in an increasingly competitive global marketplace.

As I said earlier, I support the concept of national industry-recognized skill standards. However, I do have several concerns with this bill, as it is currently drafted.

Therefore, In an effort to clearly set forth my beliefs about the federal government's proper role In developing and implementing national skills standards and, hopefully, to facilitate bi-partisan agreement, I am supporting Senator Kassebaum's substitute to Title IV of this bill. In my opinion, this substitute has several major advantages over Title IV of the Majority's bill.

—First, the standard-setting procedure provides a better opportunity for industry to take the lead in developing outcome-based occupational standards.

—Second, the Federal Government's role in developing and implementing national skills standards is much more limited.

—Third, while the Federal Government's role is specific enough to develop effective systems for measuring success and failure, it is flexible enough so that it does not impede the progress of the stakeholders in developing and utilizing skill standards.

—Finally, the standard-setting procedure set forth in Senator Kassebaum's Minority substitute will help monitor and measure achievement of objectives based on outcomes—rather than compliance with input-oriented rules and regulations.

Mr. Chairman, the Minority substitute is not perfect. But believe that It begins to move this debate much farther in the right direction. I am supporting it in the hope that it will begin a dialogue that will ultimately produce the best education and occupational skill standards legislation possible before any bill reaches the floor. hope my colleagues will join me in a constructive, bipartisan effort to achieve that objective.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Durenberger.

Our friend and colleague Senator Simon, along with Senator Durenberger, have been real leaders in this area. Paul, we are glad to hear from you.

OPENING STATEMENT OF SENATOR SIMON

Senator SIMON. I thank you, Mr. Chairman. You are too generous, and my colleague from Ohio has been too generous. Yes, Senator Durenberger and I have been working on this for a couple of years, but this is not a new thing. In 1978, a Senator from Massachusetts named Ted Kennedy introduced this legislation. We are not talking about some brand new idea that has suddenly emerged on the scene.

This is a program that is good for students, good for taxpayers, and good for schools. It will help students and their families. It is supported by the U.S. Student Association. It is supported by virtually every higher education association. And on the other side, it is opposed by virtually all the financial organizations.

This committee has a choice. Is this going to be a higher education assistance bill, or a bankers guaranty agency and Sallie Mae assistance bill? I do not have a tough time making a choice in that kind of situation, because the guarantee agencies and the others have been very vocal, and obviously profit from the present system.

Yesterday, I got a letter from Joe McCormack, the former CEO of the Texas Guarantee Agency, one of the largest in the country. He says—and I am quoting from his letter, and I'd like to enter his letter in the record as well as one from some officials of the University of Illinois, and Associated Colleges of the Midwest, and the University of California, as well as a letter signed by six former presidents of the National Association of Student Financial Aid Administrators—but in his letter, he says, among other things: "My experience in administering the current program compels me to strongly support President Clinton's proposal to reform the Federal role in student loans in this country. President Clinton's proposed direct loan program offers the opportunity for the Congress to achieve budget savings unparalleled in the history of student loans, provides the Department of Education with the opportunity to build a greatly simplified and efficient student loan program, fully integrated with all other Title IV student aid programs and, most of all, provides students and their families the assured access to loans they need to pursue postsecondary education opportunities. Painful as it is to let go of the past, we must embrace the future with the new ideas, the new solutions, and the new commitment to serve the loan reform act of 1993 offers."

Let me add, this is not a partisan issue. Senator Durenberger has been great. One of the leaders in the House, the first Member of Congress to introduce this legislation, was Congressman Tom Petri, a Republican from Wisconsin.

This committee through legislation created a special commission to look at this. Senator Paula Hawkins, former Republican Senator from Florida, chaired that commission. That commission, not by a 5-to-4 vote—I don't know how many members were on the commission—but that commission unanimously, after looking at this carefully, came to the conclusion that this is what is needed.

As to the studies, we have OMB, CBO, and what has not been cited here—GAO says we will save $1 to $1.3 billion a year. I have heard from the other side that perhaps we should reduce the fees to the banks and the guarantee agencies. Two years ago, they were in here testifying that if we reduced their fees, they couldn't make loans to students anymore. Now, suddenly, the tune has changed, and they have a real financial stake here. I have cited this before, and until this bill passes, I am going to cite it again. Just to illustrate what is at stake, the salaries of the Student Loan Marketing Association, 2 years ago, with Government-guaranteed loans—no great risk involved in doing this—the salary of the CEO at Sallie Mae was $2.1 million. The number five executive, way down there, received a salary of $726,000 a year. The salary of the President of the United States is $200,000 a year. This is with taxpayers' funds. Why are they out there trying to get students to stand up in their behalf? I think it's pretty obvious why they are out there.

Senator Jeffords said this is the second hearing we have had on this subject—this is the third hearing we have had.

The two reports cited by my friend Senator Hatch that are critical of this—those two reports were paid for by the financial institutions that profit from the present system. We should view those reports with the same skepticism we view the reports of the Tobacco Institute when they come in with research showing that cigarettes don't do any harm; those reports have about as much validity.

I think our choice is clear, and let me join my colleague Senator Metzenbaum in expressing resentment at the way they are proceeding in attempting to set up these student fronts to basically lobby against the program that is great for students. It is like the cigarette manufacturers setting up a "physicians for cigarette smoking" front.

If Sallie Mae and the others want to lobby us, go ahead and lobby us. That is the way this process works—but don't set up some phony student front and say the students are opposed to this.

This morning, I received a letter from the President of the United States which I would like to read:

> When I announced my new direct student lending program recently, I warned that the special interests with a financial stake in keeping things the way they are would come out in full force to block change and prevent progress. I am afraid that I could not have been more right. The lobbying of special interest groups trying to protect their Federal subsidies under the guaranteed student loan program has hit a new low. Their effort to conjure up student opposition is just one more example of Washington lobbyists playing games at the public's expense. The public wants and deserves change that puts the public interest above the self interests of those who simply want to protect their subsidies under the status quo. Our new student loan structure will provide that change.
>
> I appreciate what you and your colleagues are doing to bring to light the dubious lobbying efforts directed against these reforms.

Mr. Chairman, I think we have a clear choice, and I hope we make a decision in the public interest.

Thank you.

The CHAIRMAN. Thank you very much, Senator Simon.

Senator Coats.

OPENING STATEMENT OF SENATOR COATS

Senator COATS. Mr. Chairman, I will attempt to summarize my statement because I want to respond to a couple things that have been said earlier here, although I need to caution you that sometimes the summary is longer than the statement, but I'll try to be brief.

It is apparent from the testimony here this morning, I think, that there are members on both sides who have differing views of this. So in response to my friend from Illinois, clearly, it is not a partisan issue. There are both Democrats and Republicans on both sides of the issue, and those that do have, I think, legitimate questions about whether we ought to move as the President wishes immediately to a direct lending program, I think those questions are legitimate.

Now, having said that, I want to say to both my friend from Minnesota and my friend from Illinois that I am well aware of your sincere interest in providing a better means of access, at a cheaper cost, for higher education for young people in America. I think that is a very commendable and worthy goal, and I know both of you have spent a great deal of time and effort on this particular program, and I commend you for it, because I think that the goal is very, very worthy.

However, just because the goal is worthy, it doesn't mean that there aren't legitimate questions out there that I don't believe we yet have the answers to.

And in response to the Senator from Illinois, who said—and I don't want to misquote him, so I wrote it down—that direct lending is supported by virtually every institution and opposed, of course, by the banks and the lenders, and it is a clear choice——

Senator SIMON. By virtually every educational association.

Senator COATS. But I have a long list of institutions just from my own State of Indiana that have raised very serious concerns about moving to this particular program. The director of financial aid from Notre Dame has written, submitting real concerns and dozens of questions that he asked me to provide answers for relative to how this would work and how it would impact the University of Notre Dame and how it would address his questions as to the efficiency of the program. I think we need answers to those questions.

I have also received a letter from the director of financial aid at Purdue University. Purdue is one of the pilot schools, and I would just like to quote a couple things that were written in that letter that I received from Joyce Hall, who is the director of financial aid at Purdue University, particularly in response to the question raised about the legitimacy of those who are "lobbying against" the change.

"School concerns," she says, "are currently be characterized as panic or hysteria created by the evil empire of banks and guarantee agencies and being summarily dismissed. I prefer to characterize school concerns as legitimate skepticism when a wholly new Federal bureaucracy could be thrust upon us without adequate testing. Many of us who have managed these student aid programs for years are quite capable of separating the facts presented on both sides of the issue and making intelligent analyses of the issue."

In response to the question of the reports and the information before us, and some of the reports being financed by the guarantor agencies, it is also fair to point out that CBO has been all over the lot in terms of the cost estimates of this, and they make a number of assumptions, which I think we ought to at least question the validity of. And CRS has also reported and indicated three major concerns, if I could just enumerate those quickly. One, a large portion of the savings claimed by GAO are not savings. Two, any savings that will truly result from direct lending could be made by simply adjusting the existing Federal Family Education Loan Program. And three, administrative costs for the program would likely increase. I think those are legitimate questions raised by legitimate agencies that are taking an objective look at the situation.

In that regard, I would commend both the chairman and my friends from Minnesota and Illinois for at least raising attention to the fact, because now the lending organizations, guarantor organizations, have come forward with I think some interesting proposals to achieve that $4.3 billion savings which the committee is charged with coming up with, in fact even exceeding it. So it is having a positive effect even if the legislation is not adopted at this time.

And I guess I would say finally that when you have a proposal that has the far-ranging implications and impact that this program would, that imposes on nearly 8,000 higher education institutions a new administrative burden of which they are not exactly sure how they are going to administer and how they are going to do that in a cost-effective way, when it transfers to a department of Government which has, frankly, a pretty dismal record in administering student aid programs, I think those are questions that we ought to look at very, very carefully.

I offered an amendment last year in committee here, which was adopted by the committee and finally adopted in the conference, to put some of these sham schools out of business if their default rate exceeded a certain amount. That was something that the Department of Education just ignored, either through oversight or through negligence. And it was the guarantor agencies that kept bringing it to our attention and kept telling me that we are costing the taxpayer a lot of unnecessary dollars here, that they are mandated to make up for, because the Department of Education frankly was not doing its job and was certifying schools that were providing education in blackjack dealing, in cosmetology, in astrology, and in a whole number of very questionable educational endeavors. And it wasn't the Department of Education that was drawing attention to this; it was the guarantor agencies that were doing that.

So it seems to me that the committee came to a wise decision, which is, first, does the proposal of the Senator from Illinois and the Senator from Minnesota have merit? The answer was yes. Is it something we ought to look at seriously? The answer was yes. Are there questions about how it would be implemented, whether we would reach the cost savings, whether the assumptions were right, could the schools administer it, could the Department of Education take on this administrative burden and do it in an effective way—question mark; we are not sure.

So how do we proceed? Let's do a pilot program. Let's allow schools of different sizes, in different States, different areas, to test the concept, report back to us on a regular basis, and then on that basis we will make a final judgment as to whether the best way to go is partial direct lending, full direct lending, or stay with the current system.

I think any business would operate on that basis, and given the fact that we are facing this enormous deficit, that the public has legitimate questions about the ability of Government to do anything more efficiently than the private sector—I am hard pressed to come up with a program right now that they have—given the concerns about the ability of the Department of Education to administer this program efficiently and effectively, doesn't it make sense to allow the pilot program to test out, to report back to us, to let us evaluate it, and then let us make a rational decision as to where we ought to go. So I guess I speak strongly in support of the efforts of Senator Kassebaum, who garnered an awful lot of votes on the floor from members of both sides of the aisle last year, to continue the pilot program, get the results in and then make a final decision. And I would urge the committee to follow that course of action.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Coats.

[The letter referred to follows:]

PURDUE UNIVERSITY, DIVISION OF FINANCIAL AID
May 21, 1993.

The Honorable Dan Coats,
United States Senate,
SR-407 Russell Senate Office Building,
Washington, DC.22510

DEAR SENATOR COATS: As director of financial aid at Purdue University, I am responsible for managing a major student aid program which includes over $50 million in Title IV student aid program funds. Purdue University represents 60,000 Students. I am keenly interested in the current proposal before the Senate

which would make the direct loan program a full-blown program without a pilot test of the program.

In the past, Purdue has supported the concept of a direct loan pilot program. We continue to support this concept as a pilot program. I am deeply concerned that the direct loan pilot could be disbanded in favor of an untested full-blown direct loan program.

School concerns are currently being characterized as panic or hysteria created by the evil empire of banks and guarantee agencies and being summarily dismissed. I prefer to characterize school concern as legitimate skepticism when a wholly new federal bureaucracy could be thrust upon us without adequate testing. Many of us who have managed these student aid programs for years are quite capable of separating the facts presented on both sides of the issue and making intelligent analyses of the issues.

During my 15 plus years of experience managing student aid programs, I have been fortunate to be at Purdue University. The student aid office has a history of embracing innovation to better manage student aid programs. Purdue was one of the first of five schools to participate in the Department of Education Quality Control Project. Purdue continues its strong support as this program has moved from pilot status to full program status. Something as important and potentially innovative as a direct loan program deserves no less than adequate testing. The current Federal family education loan programs should remain intact during the testing and analysis phase before a decision is made to proceed with direct lending nationwide.

Much has been said and written in the past 2 years about the controversial topic of direct student loans. Some of my concerns are as follows:

1. The National Service Program has been deemed worthy of being pilot tested before consideration of full implementation. Why then would Congress want to undertake a major shift in student lending without a pilot test? Thousands of students stand to gain or lose under the new program.

2. There are serious reservations that the Department of Education can manage a full-blown direct loan program without adequate pilot testing. Permit me four anecdotes:

a. Three years ago my office moved from one building on campus to another on campus—literally across the mall area. For 3 years my office sought advice from the department on how to get Our address corrected on our Student Aid Reports. Each time we were told that Purdue would have to fill out the reams of paperwork required to be certified as an eligible institution. This year we pursued the address correction issue to a higher authority in the department and the address was corrected the next day.

b. Most recently, schools have suffered losses of thousands of student aid records because the Department of Education chose not to provide students with a code list of their schools with the new Free Application for Federal Student Aid as a cost-saving measure. Students using only the name of their school, not a code, will tend to abbreviate. The department processor cannot send the student aid records to schools when an abbreviation is used. Is the dollar savings in not providing the school code list to students worth the problems and aggravation being experienced nationwide now?

c. The FISL (Federally Insured Student Loan) program was established in 1965 to provide loans in areas not served by guarantee agencies. By the 1976 reauthorization, the decision was made to phase out the FISL program. The Department of Education (then under HEW) was unable to manage this guaranteed loan program directly to lenders or schools. It is clear that pilot testing would have been useful.

d. Additionally, I am concerned with the department's ability to provide timely regulations and guidelines. In October 1992, the department issued Federal regulations that pertained to legislative changes that were invoked in July 1991. Of course, the published regulations were policies retroactive to the time of their enactment. The financial aid community was very concerned that operational procedures at the local school or agency level for more than a year were not in agreement with prescribed law. The public voiced concern to the administration regarding the lateness in receiving the federal regulations and asked the administration to disclose what penalties would be rendered to schools and agencies not in full compliance. As soon as the Clinton administration took over, the Secretary apologized for the previous administration's lateness in delivering regulations "ex post facto" and announced that schools and agencies would not be held liable for regulations as long as schools and agencies could demonstrate that there was "good faith effort and diligence" in interpreting and carrying out the July 1991 regulations.

The staff in the department have always been eager to serve the public and especially the students that we all serve through the Federal student aid programs. However, the department has demonstrated through the test of time that they are not staffed and structured to properly carry out the demands of implementing and overseeing newly created Federal aid programs without first testing them through pilot stages.

3. There is much skepticism about the projected savings in a full-blown direct loan program. A pilot program will quantify once and for all the real savings. In the meantime, current program cost can be cut at the lender and guarantee agency levels. Congress approved the subsidy structure which has allowed the current profit level and has the power to modify the level of profit received.

4. The direct loan program operations have the chance to dramatically alter the loan process into a fully electronic mode. This level of sophistication demands pilot testing. In the meantime, the recent approval of a common application under the current process shows promise of streamlining the current loan program. Other avenues to streamline the program should continue.

5. Schools would have the option of having a third party originate their loans under direct lending. At the proposed rate of $20 per application, the service provided would not be competitive.

6. The cost to schools is the subject of much debate. Sallie Mae provided a model to help schools calculate program cost. Even assuming that Sallie Mae in its own self interest may have overestimated cost, the figure can nevertheless be used as a beginning point. Assuming a 50 percent error in the Sallie Mae estimate of average cost, it would cost $50 per loan application processed. At Purdue, loan volume over the next 2 years will rise to 20,000 applications. At a cost of $50 per application, Purdue cost could be $1,000,000 annually to manage the direct loan program. This does not include first-year readiness cost and hardware cost of approximately $250,000. Again, a pilot program can answer these school cost questions.

7. The pilot program would allow testing of the cash flow to the campus.

8. Last, I am concerned that unpaid loans could be written off as bad debt if the loan has not been repaid in 25 to 30 years.

In the final analysis, I want what is best for students. If the direct loan program is viable, it will survive the pilot program phase. All students should not be used as guinea pigs for a program that has not been fully tested. Cost savings can be achieved under the current loan program through reduction of subsidies paid to lenders and guarantee agencies. Efforts should continue to streamline the current program.

The decision to replace the current student loan program and move to a nationwide direct lending program should be held in abeyance. A pilot program can answer the concerns being voiced about cost to schools, savings, cash flow, and the ability of the Department of Education to successfully manage such a program.

Sincerely,

JOYCE HALL
Director

Senator Wellstone.

OPENING STATEMENT OF SENATOR WELLSTONE

Senator WELLSTONE. Thank you, Mr. Chairman.

I think just about everything has been said. I think I'll take, hopefully, less than 2 minutes.

First of all, Deputy Secretary Kunin, I am pleased that you are here today and look forward to hearing your testimony.

I'd like to thank John Schullo for being here from Bemidji State University. And just to try to translate some of this discussion into human terms, I visited Bemidji State several times, and it is not uncommon to meet students who are working 35 hours a week while in school there. It is not uncommon to meet students in Minnesota, or any State around the country, I think, who sell plasma at the beginning of the semester to buy textbooks. And it is not uncommon to meet students who are doing their undergraduate work in 6 years because of the number of hours they have to work each year while they are in school.

I just want to build on the comments of Senator Simon for a moment, because I think the policy part of this has already been discussed. I read a piece today in The Post in which Senator Simon was talking about some of the lobbying efforts, Senator Metzenbaum talked about it as well, and also some of the power law firms and lobbyists that have been hired here in Washington from financial institutions and Sallie Mae. And I would just conclude this way. I would say to the students who are here today from United States Student Association that what I hope you all will do is, if you remember the Presidential race, I hope everywhere you go, including right outside the chamber of the Senate when we vote on this, you should have a big sign, and it should parallel—you'll remember when candidate Clinton said, "It's the economy, Stupid"—you should have a big sign that says, "It's the students, Stupid."

That is what this is about—students or Sallie Mae, students or financial institutions—who really has the access and who really has the say. You always talk about your commitment to the young. You always talk about your commitment to students. We ask you to deliver on that commitment.

I believe that is what this debate is really about.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Wellstone.

Senator Gregg.

OPENING STATEMENT OF SENATOR GREGG

Senator GREGG. I'd just like to welcome Governor Kunin. It is nice to see her, and I look forward to hearing what she has to say. She always has a lot of good thoughts, and I enjoyed working with her as Governor.

The CHAIRMAN. Thank you.

We'll include in the record statements of Senators Mikulski and Thurmond.

[The prepared statements of Senators Mikulski and Thurmond follow:]

PREPARED STATEMENT OF SENATOR MIKULSKI

Good morning, Mr. Chairman, I want to commend you for holding hearings on this very important subject matter—that is, what is the best way the Federal Government can help American students finance their education?

Every one knows the importance of students being able to attain a college education. Easy access to funding for college is critical to our students who want the opportunity, to our parents who cannot afford to foot the bill themselves and to our schools that must facilitate students' financial assistance needs.

We know that the cost of college has escalated over the last several years. It has always been difficult for our low income families but it is also difficult now for middle income families to obtain enough funding for them to afford college.

Mr. Chairman, as you know, the issue of direct lending is not new. But the questions addressed in this hearing today will certainly help us understand whether we should maintain the status quo or implement the direct loan program.

In making this determination, we must carefully examine the ability of the Department of Education to handle direct loans, whether safeguards are made a part of the direct loan initiative, and whether the transition, or phase-in, of this proposal is carefully thought through. The last thing we want is to tinker with the current student loan process to our detriment.

Mr. Chairman, my commitment to assuring that Americans have access to college aid is without question. I supported the Higher Education Act amendments last year because I wanted to increase access to student loans for all students. We need college aid programs that operate efficiently and are ultimately in the best interest of the students and American families.

The question today is not whether people need funding to attend school—we know they do. But, instead, what is the best way the Federal Government can help provide educational assistance and help provide people the opportunity to obtain a degree in higher education?

It is important that we examine these issues carefully to ensure that we accomplish our goal of having the most effective process for our students, Parents and institutions. I look forward to the testimony of today's witnesses.

PREPARED STATEMENT OF SENATOR THURMOND

Mr. Chairman, it is a pleasure to be here this morning to receive testimony on S. 920, the Student Loan Reform Act Of 1993. I would like to join my colleagues in welcoming our witness here today.

Mr. Chairman, S. 920 would change the way student loans are disbursed and collected in an attempt to save the Federal Government money it currently spends to guarantee loans with banks and other lenders.

The Student Loan Reform Act would dismantle the current program that has funded and administered student loans for nearly three decades. It will replace this system with a taxpayer funded and government administered program. Under S. 920, the government would lend money directly to students through schools, which would serve as loan originators. I am concerned that most postsecondary schools have no experience as lenders.

I am also concerned that the Federal Government will now be borrowing approximately $15 to $25 billion per year to replace the private capital currently provided by banks to fund the program. This money would be added as a liability to the Nation's debt.

Although the cost saving estimates of $4.3 billion reported by the Government Accounting Office (GAO) would be substantial, I am concerned that this estimate is not accurate. Many of the administrative costs of this program are not included as part of the Savings estimate. Also, recent studies by the Congressional Research Service, Ernst & Young, and PMG Peat Marwick refute the estimates of cost savings and have found the GAO report flawed in a number of its assumptions.

Mr. Chairman, less than a year ago we authorized the implementation of a "pilot" direct loan program under the Higher Education Amendments of 1992. After extensive debate on this subject, the pilot was authorized because there were considerable questions relating to (1) whether such a program could be effectively administered by the Department of Education and (2) whether any real savings would result.

We must question whether we should risk the failure of a direct lending experiment, which shifts the responsibility from an established loan delivery infrastructure to an unproven Federal bureaucracy. I believe we should allow the implementation of the pilot program so that we may determine if there really is a better way to administer this program.

Again, I would like to welcome our witnesses here today and I look forward to reviewing their testimony.

The CHAIRMAN. Governor Kunin, we are glad to have you here. It is now about 7 minutes of 11. We almost started our hearing this morning a little earlier so that our comments would not be on your time. As you can well tell, there is a diversity in the approach, but we have, I think, a very genuine desire to work with you and the administration on an issue which is of such enormous importance to the young people and the educational system.

I think all of us on this committee understand that higher education in our universities is one of the enormous success stories in the postwar period. If you look at the top 140 universities in the world, probably 125 of them are in the United States. So we are very proud of that, but we also on this committee want to make them even better, and we welcome your testimony here this morning.

I understand you are accompanied by Assistant Secretary Maureen McLaughlin and Thomas Skelly, the budget system director. We want to thank them very much for being here as well.

We'd be glad to hear from you.

STATEMENT OF MADELEINE M. KUNIN, DEPUTY SECRETARY, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, DC., ACCOMPANIED BY MAUREEN McLAUGHLIN, ASSISTANT SECRETARY, AND THOMAS SKELLY, BUDGET SYSTEM DIRECTOR

Ms. KUNIN. Thank you very much, Mr. Chairman and members of the committee.

As you so well put it, Senator, there is a diversity of opinion as to how we approach this issue, but let me assure you that the President in making this proposal and the Department of Education, and Secretary Riley and I, are keenly aware of an almost sacred trust that we have here in maintaining our commitment to students and to having access to higher education as part of an American birthright.

It is a pleasure especially to have this opportunity in light of all this debate to be able to present the facts and to describe the bill and also to separate some of the myths from the realities.

First of all, let me make absolutely clear that the Clinton proposal, known as "The Student Loan Reform Act of 1993," will meet three very important goals: 1) simply to make college more affordable by making it easier for students to pay off their loans through flexible repayment terms, and once the program is implemented, through lower interest rates; 2) to save taxpayers substantial sums of money, and 3) to streamline a very complex student loan system.

Now, one might well ask, as has already been asked in the questioning, when we have such an opportunity to make Government work better, how could one argue with the results and with such a plan to achieve it. Recognizing there is always going to be honest disagreement over how to get there amongst reasonable people—and that is certainly reflected in the comments from the committee—there is no question that one reason that there has been such objection to the plan is that those who are enjoying substantial benefits from the present system—the banks, the guarantee agencies, Sallie Mae, State secondary markets, and others—have a very strong interest in maintaining the status quo.

I think it is important to note that the legislation was introduced by the President just 2 weeks ago, so the full facts and the details on exactly how the program would work really were not put on the table until that time. The arguments, of course, and the buildup against the program started long before the details and the actual legislation was known to the public. In the current program, billions of taxpayer dollars go not to students, but to 7,800 lenders, 46 guarantee agencies, and numerous service and secondary markets.

To its credit, this complex array of participants has provided millions of loans to students and their families each year. But they are also paid exceedingly well to do so. And we need only look at the flurry of alternative proposals, largely generated by the providers, that reduce profits to have stark evidence of the fact of how well-paid the present system is and to what extent excess profits exist.

Now, the intensity of recent lobbying efforts against student loan reform is a useful reminder of what is the central purpose of the loan program. It is, in our opinion, to serve students, not to preserve the present system for the benefit of providers. And, as has already been noted, these groups have hired some of the highest-paid lobbyists in town to help convince both the Congress and the public that the President's program will not work. And I must say that what they have been saying is at best misleading and often just plain inaccurate and wrong.

Let me dispel six myths that have been raised about the President's program, and I will briefly discuss as well the limitations of the alternative proposals that are being offered and briefly describe the main components of the President's initiative.

The first myth, and frankly, the most distressing, is that the entitlement to loans for students will be lost, and students will be hurt if direct lending is put into place. The reason this is so disturbing is that we know that half of our students are dependent on student loans, and we do not want to create undue, unrealistic, unsubstantiated anxiety by any program that is placed before the Congress for consideration.

The reality as opposed to the myth is that students will continue to have access to the same amount of loan capital as they have had in the past. In fact, students will be better off under the new program because they will have more flexible repayment options and, ultimately, lower interest rates.

The second myth is that direct lending saves money only by shifting costs to colleges and universities. Therefore, the concern raised by some colleges and universities and some financial officers—let me just say parenthetically that I have a copy of the letter sent to Senator Coats by the financial aid officer at Notre Dame, and we are responding to each of those concerns.

Senator COATS. Thank you.

Ms. KUNIN. The president of Notre Dame, on the other hand, is supportive of direct lending in his comments to me. So sometimes, we have different views from different folks within the same setting.

Senator COATS. He isn't the one who fills out the forms.

Ms. KUNIN. Let me just say that some anxiety has been created because of rumors rather than the facts of the bill as to how institutions would actually be affected by this legislation. And let me take this opportunity to say very clearly that administrative costs will not be shifted to colleges and universities. There is absolutely nothing in the legislation to substantiate that claim.

We have very carefully crafted the legislation to recognize that not all colleges want to do direct lending, and not all colleges should do direct lending if they are not capable of exercising appropriate fiduciary responsibilities. Those that do want to will be paid a fee to do so; those who do not want to will be assigned an alternative originator, a contractor, on a competitive basis, without charge to the institution. So we recognize that colleges should not be burdened by this responsibility, and the legislation does indeed not burden them in that regard.

The third myth is that savings estimates for direct lending are wildly overestimated, and we certainly heard that substantiated today. Let me just veer from my formal testimony and address a few of those concerns right off.

One is the different reports from CBO and GAO and so on. They have been reconciled. Originally, there was a $3 billion difference. Today, we are all in agreement that the 4-year savings will be $4.3 billion, and the steady-state, long-term savings will be $2 billion. So there is not the kind of difference that originally entered this debate.

I also go back to a 1992 GAO study on direct lending which was made for the House, and even in 1992, the report says a switch to direct student loans could save the Government about $4.8 billion in present value terms. So I think we are in the same ball park, and obviously it took some work to get there, but there are not very wide gaps or differences of opinion in this regard.

It is also important to put that amount of savings in perspective. What does it mean to save $2 billion a year? What it means, basically, is that one out of three dollars presently spent on student loans, as the GAO report says, will be saved. One out of three dollars that are now being spent in ways to finance student loans could instead be used, obviously, to benefit students and benefit the taxpayers.

So this is a significant savings, not a marginal savings.

The major cause for the savings comes by substituting Federal borrowing for private capital, and our cost estimates do include allowances for administrative costs, and we have also included costs for establishing and operating direct loans as well as the transition, which is a very important administrative responsibility which we in the Department are very cognizant of. And the Congressional Budget Office has confirmed these savings.

The fourth myth is that direct lending substitutes a Federal bureaucracy for the efficiency of the private sector, and Senator Durenberger has already made the point very well that this is not really an entrepreneurial system when the players are guaranteed fixed rates of return, and our proposal for direct lending really says that we are going to choose contractors; the services will continue to be performed by the private sector, but will be chosen on the basis of price and of quality through a competitive system. So that is extremely important that we are introducing genuine competition and therefore genuine quality control.

Again, it is the competitive forces that really lead to efficiency.

The fifth myth is that the Department of Education cannot manage the current system and that a new, untried system will be even more difficult. Let me pause. We are keenly aware that the Department of Education must strengthen its management capacity. But let me say we are absolutely committed to making the Department of Education a model agency in the United States Government. This is a commitment that is strongly shared by the President, by the Secretary, and by every, single person within the Department. It is clear that taxpayers deserve nothing less.

And I might add that regardless of whether we move to direct lending or we continue with the current program, we are on the road to management improvement and to excellence.

We realize that—and originally, I was going to be brief in my management remarks, but obviously this is a major concern of the committee, and I think it is worthy of some elaboration. What is good management of any program? I think the first question one has to ask is clearly define your mission. And the mission, frankly, in the student loan program, whether it is guaranteed student loans or direct lending, has sometimes sent mixed messages. One message is: Get the loans out, get the grants out, provide eligibility for anyone who is eligible, and reach as many students as possible. And that is a very important part of the mission, because we are in the business of access to education.

But in our urgency to do that, I think the second part of our mission and responsibility has sometimes taken a back seat, and that is to protect the Federal financial interest and protect the taxpayer. Our mission as we redefine it with this new administration is really to blend both, to achieve both—to continue access, but to do it in a financially responsible manner and to exercise our fiduciary responsibility to the taxpayer.

We are prepared to provide the leadership and to take the responsibility for making this program work. In contrast to the previous administration, we do believe direct lending can work because we are committed to making it work. As you know, the opposition was there within the administration just a short time ago.

And you have to ask what is management composed of. In my opinion, it is composed of people, it is composed of having a process that works, and it is composed of having the backup systems in terms of technology to really be able to deliver on the details. And Senator Dodd was absolutely right when he said in this program we have to deal with the technicalities. We cannot simply have promises. We cannot simply have rhetoric. We have to back it up with a delivery system that serves the students and that serves the colleges most of effectively.

People—well, the person who is the designee for assistant secretary of postsecondary education, who with your good graces and approval will be the secretary, is undoubtedly the most knowledgeable person in the United States of America on the question of student loans. That is why the Secretary and I selected him. And he is ready for the challenge. He is an expert, he is a manager, and he is eagerly looking forward to implementing this program and making it work.

We are not relying, however, even on one person alone. He in turn is going to bring in two deputies with very highly honed fiscal skills. We need people who know this business, who know it inside out, who know what works and what doesn't work, and who have the ability to crack down when it doesn't work.

We also, I might add, are not depending solely on political appointees. To my right and to my left, you see two people—Tom Skelly and Maureen McLaughlin—who represent some of the very best of the career service within the Department of Education, and we could not be here today with this legislation without their assistance. I might say even developing this legislation has created a tremendous new spirit within the Department, where people work weekends, people work nights, people have an extraordinary dedication to the sense of mission of this Department.

We still have more work to do—there is no question—but we have embarked on rejuvenating what has been a sleepy place. It is awake, it is ready for action, and people want to do well in their jobs. I think the combination of highly talented new appointees and a highly motivated work force within the professional career service will give us the capacity to be good managers and really manage the public trust in terms of providing loans to students as they expect, and doing it in a timely and cost-effective way.

We have also made some process changes. The biggest process change, of course, in this legislation is that the whole process is much simpler. The GAO report said time and time again, you cannot administer this program—nobody can administer this program. And here is a chart that comes from their own report; for those of you who remember Rube Goldberg, it looks like one of those contraptions, or it looks like one of the gadgets at Logan Airport that has this pinball going from one place to another. But no reasonable person would set up a system as complex, as difficult to understand as this one today. Simplicity leads to accountability. It is only when we know where the buck stops that we can really control whether or not that buck is in fact being well-spent.

This Congress did last year make some changes that give the Department higher capability for good management. For example, we have implemented some changes, such as the greater guarantor and lender oversight. We have a separate office for guarantor and lender oversight. We have stepped up oversight that, for example, has led to the assessment of guarantor liabilities in excess of $100 million during last year. We have stepped up our default collections—in fact, two of our employees were honored by Secretary Bentsen last week for a very original way of collecting on defaults using Western Union for collections, and they had a record collection success story. It is these kinds of both technical and process changes that give us the capacity to manage this program.

But clearly, we are taking on a large responsibility, and it would be irresponsible to sit here and say we can just do it with business as usual. We can't do it with business as usual. We need the support, we need the staff. There is a request for increased work force, as has been pointed out—some for direct lending, some 350; 198 for transition. But the present system is not a free ride. The present system is extremely expensive. You don't see it in terms of Government employees, but it is layered throughout the system in terms of subsidies, in terms of allowances, and that is where the difference is.

We are confident that with the new commitment to management, with the new sense of mission, with support from the Congress, with assiduous and constant attention to detail, we can manage this program effectively, and that the net result will be that the student will be better served than under the present system. And that is a commitment I make, expecting to be fully held accountable for the results.

The Secretary has asked me as deputy secretary to take management responsibilities, and I and the rest of the team at Education are fully prepared to do so.

I will be happy to get back on this in questioning if you have further questions.

Another question that has been raised is that it is irresponsible for the administration to abandon the demonstration program authorized by the Higher Education Amendments of 1992 and move to full implementation of direct loans. In fact, the President's proposal will phase in the program, and I think that is a very important point that has not been strongly stressed.

We are not moving to direct lending from 1 day to another or 1 year to another; we are going at exactly the same pace in the first year as the demonstration program prescribed at 4 percent of the phase-in, and that will allow us to self-correct. Sure, there are going to be glitches. This is major new initiative, and we want to have the time to make any modifications that may be necessary. If we simply did the demonstration program as designed, one, we would not save the money; two, we wouldn't learn what we really should learn, because it is too small, it is too long-term, and it would take us at least 10 years to get any results, and that would be on a minuscule, not representative basis.

I think it is also clear that the pilot or demonstration program was really a compromise that was part of a similar debate that occurred a year ago, offered by those who opposed direct lending. If we are going to move forward on direct lending, let us do it in a prudent way, step by step, phase it in, learn from our mistakes, and develop a program that works. We again are confident that this phase-in schedule will allow us both the time and the experience to do it correctly.

A word about the alternative proposals. For the first time in several decades, the current middlemen—banks, guarantee agencies, and Sallie Mae—are putting forth proposals to reduce their profit. I guess it is fairly obvious why this is happening, that it is the fear of full direct lending that has suddenly caused this turnabout. As has been noted, never before in this debate could one reduce any subsidy or allowance; without having the red flat raised, the whole system is going to collapse.

But there are some concerns about these alternative proposals. Obviously, we urge you to look at them; we are analyzing them, but they don't do certain things, and they do raise other problems. One is there is no structural reform in any of these alternative proposals that we have seen. And two, there are some risks. There are some risks that if their profits are reduced as substantially as they claim they can reduce them, the risk is will they continue to serve all the students including those who have high-risk loans, or will they begin to slough off some of the more expensive, more complex loans from the system. Then I think your phones would certainly ring if that were to begin to happen. That is one possibility, certainly, when you take a huge chunk out of the profits of an existing system.

Second, there is another risk—are they going to be back next year? Is this only a proposal made this year to ward off direct lending, and will they be coming back next year, "Sorry, we need more money; it didn't work." Certainly, you have seen that scenario occur before.

The most important point, though, about the alternatives which I would urge you to scrutinize very carefully is they really do not expand benefits to students. Only in our direct lending proposal can we make the promise that students will benefit from lower interest rates once the program is fully implemented, that they will have greater simplicity, and that they will have further options as to how they want to repay their loans.

The other major difference between our proposal for direct lending and the alternatives is the long-term savings. The difference between $2 billion and $1 billion, I am sure Senator Jeffords would agree—in Vermont, that's still money, and I think it is in Washington as well—that this is a substantial difference of savings that we must consider for the taxpayer.

Now, it has been asked should we move forward simply to save money. No, we should not move forward simply to save money. Saving money is important. Retiring the deficit, everyone on this committee and everyone in this chamber would agree, is a responsibility we have to the American public. But we see this program as having equal responsibility to American students and their families, for whom access to higher education is a necessity today in order to earn a decent standard of living.

I will forego going through the specifics of the program; I am sure they will come up in questions. But let me conclude by saying that when we are comparing the present system to the proposal for direct lending, we should not assume that the present system works like a well-oiled machine. It does not. In 1 week alone, the

Department received more than 2,000 letters concerning defaulted student loans, another 1,700 letters asking for information and clarification of provisions of the Federal Family Education Loan Program. These letters clearly illustrate the confusion and complexity inherent in the current program.

We believe we can and we must do better. We must do better to serve students and the taxpayers by giving them a program that is simple, direct, less costly and less confusing. The Student Loan Reform Act of 1993 will start us down the road toward accomplishing these goals and will enable us to improve our service to our most important clients that we all care about—America's students and the taxpayers.

Thank you very much, Mr. Chairman, for this opportunity.

[The prepared statement of Ms. Kunin follows:]

PREPARED STATEMENT OF MADELEINE KUNIN

Mr. Chairman and members of the committee, it is a pleasure to be here today to testify about the President's initiative to revamp student loans, the Student Loan Reform Act of 1993, an important companion piece to national service. President Clinton's bold new proposal will meet three important goals:

- Make college more affordable by making it easier for students to pay off their loans, through flexible repayment terms and lower interest rates.
- Save taxpayers substantial sums of money, and
- Streamline the student loan system.

One might well ask when we have such an opportunity to make government work better, who could argue with a plan to provide better benefits to students, while significantly reducing Federal costs, and creating more efficiency? The answer is obvious: those who are enjoying substantial benefits from the present system—the banks, guarantee agencies, Sallie Mae, date secondary markets, and others.

In the current programs, billions of taxpayers' dollars go, not to students, but to 7,800 lenders, 46 guarantee agencies, and numerous servicers and secondary markets. To its credit, this complex array of participants provides millions of loans to students and their families each year. But they also are paid exceedingly well to do so. The flurry of alternative proposals that reduce profits provides stark evidence of this fact.

The intensity of recent lobbying efforts against student reform is a useful reminder that the purpose of the student loan program is to serve students, not to preserve a system for the benefit of providers. These groups have hired some of the highest paid lobbyists in town to help them convince you and the public that the President's proposal will not work. What they have been saying is, at best, misleading and often just plain wrong.

Let me dispel six myths that have been raised about the President's proposal. Then I will briefly discuss the limitations of alternative proposals that are being proffered and describe the main components of the President's initiative.

MYTHS AND REALITIES

The first myth is that the entitlement to loans for students will be lost, and students will be hurt.

The reality is that students will continue to have access to the same amount of loan capital as they have had in the past. In fact, students will be better off under the new program because they will have more flexible repayment options and, ultimately, lower interest rates.

The second myth is that direct lending saves money by shifting costs to colleges and universities.

We do not foresee increased administrative costs to institutions and have carefully crafted the legislation to meet that intent. Moreover, no institution will be forced to originate loans.

For institutions of higher education, originating loans and reconciling the amounts disbursed will be the only new activities required under direct lending. Institutions already determine eligibility, counsel students, interact with guarantee agencies and lenders, and deliver loan funds to students. In addition, institutions participating in the Perkins program already originate loans and reconcile funds.

Institutions will receive a reasonable fee if they originate loans. Nevertheless, not every institution will be able to originate loans, and some may simply not want to. In these cases, an alternative originator will be available at no cost to the institution, and all students will be served.

The third myth is that savings estimates for direct lending are wildly overestimated.

Direct lending will save $4.3 billion over the next 5 years by substituting federal borrowing for private capital. Our cost estimates include prudent allowances for administrative costs. We have included costs for establishing and operating direct loans, as well as estimates of costs associated with the transition from guaranteed loans to direct loans. The Congressional Budget Office has confirmed these savings.

The fourth myth is that direct lending substitutes a Federal bureaucracy for the efficiency of the private sector.

The reality is that the President's proposal will build a new public/private partnership, through the competitive selection of contractors, who will be chosen on the basis of price and quality, to act as alternative originators and to service loans. The current system uses private lenders to provide capital to students and to service loans, but it does not use competitive forces to reduce costs or ensure quality service. Instead, by statute, all lenders, no matter how well they perform, receive the same rate of return, 3.1 percentage points above the Treasury bill rate.

The fifth myth is that the Department of Education cannot manage the current system and that a new, untried system will be even more difficult.

We are keenly aware that the Department must strengthen its management capacity and are working assiduously to develop that capacity. Taxpayers deserve nothing less. Regardless of whether we move to direct lending or we continue the current program, we are committed to improving management in the Department of Education. Moreover, the new program will be easier to manage because direct lending eliminates many middlemen. As recently pointed out by the General Accounting Office, the current system's complexity—involving thousands of interactions between schools, lenders, secondary markets, guarantee agencies, and the Department-makes it error-prone and extremely difficult to monitor. The GAO concluded that the "program's structure is not conducive to good financial management."

In the transition period, however, we will be running dual programs as direct lending is coming on line and the guaranteed student loan program will be maintained. It is exceedingly important that the staff we have requested be adequate to do the right job.

The sixth myth is that it is irresponsible for the Administration to abandon the demonstration program authorized in the Higher Education Amendments of 1992 in favor of full implementation of direct loans.

The President's proposal will phase the program in beginning with 4 percent of volume the first year, roughly the size of the demonstration program. This will allow us to watch the process carefully and make changes as necessary before moving to full implementation. Each year we will evaluate our progress and report to Congress.

In addition, this is not something entirely new. The Department and institutions have experience with a direct loan program, the Federal Perkins Loan program, and we know that it works and that institutions can run it. In fact, direct lending under the President's proposal will be easier for institutions because they will not be responsible for servicing and collecting student loans, as they are in the Perkins program.

ALTERNATIVE PROPOSALS

For the first—time in several decades, the current middlemen—banks, guaranty agencies, and Sallie Mae—are putting forth proposals to reduce their profits. Clearly, it is the fear of full direct lending that has caused this turnabout. Previously, these same players have argued that student loans were only marginally profitable and that they would stop making loans if their financial returns were reduced in any way.

These alternative proposals would continue the current complex system but reduce payments to the maze of middlemen. These reduced incentives could result in many of them leaving the program, with capital availability problems resulting for some of the six million borrowers. It is likely that the middlemen are willing to take these cuts to preserve the current program, but if direct lending does not pass, they may well be back next year looking for a better deal. The alternative proposals have a number of other significant problems.

First, they do not generally offer additional benefits to students. Indeed, some may well erode access to loans or shift costs to students through higher guarantee fees, etc. The President's proposal, on the other hand, reduces interest rates for students at full implementation and provides a full range of flexible repayment options, including the ability to repay as a percentage of income. In addition, offering flexible repayments with the alternative proposals will be more difficult than with the President's proposal.

Second, these alternative proposals do not provide fundamental reform of the system. The President's proposal eliminates the middlemen who profit excessively from the current system and significantly simplifies its complex structure, whereas the alternative proposals continue the current system. If current players leave because of reduced profits, it would disrupt and destabilize the student loan system, resulting in reduced capital for students. The President's proposal moves gradually to direct lending over 4 years and has built-in mechanisms to ensure that access to capital will not be interrupted.

Third, the alternatives provide lower long-term savings. Although some of the alternative proposals might achieve the same savings over the first 5 years, they do not achieve the same $2 billion annual long-term, steady-state savings after 1998. Moreover, none of the alternative proposals that we have reviewed appears to provide money for dealing with capital access problems and the failed guaranty agencies that will almost certainly result.

For these reasons, we urge you to enact the President's proposal for comprehensive reform rather than proposals that make only marginal changes. These proposals will not help students; they will not simplify the system; and they will not reduce costs for taxpayers as much as the President's proposal.

THE PRESIDENT'S PROPOSAL

The Student Loan Reform Act of 1993 replaces the Federal Family Education Loan Program with the Federal Direct Student Loan Program, a system of direct Federal lending that reduces costs for taxpayers by substituting Federal borrowing for more expensive private capital and eliminating excess profits. By eliminating subsidies to lenders and making loans directly to students, the direct lending program will save taxpayers $4.3 billion through fiscal year 1998, and $2 billion per year, thereafter. The streamlined system will also be easier to understand and simpler to administer.

We propose phasing in the Federal Direct Student Loan Program over a 4-year period, beginning in academic year 1994.Our goal is to begin with 4 percent of new loan volume in the first year, 25 percent in the second year, 60 percent in the third year, and full implementation in academic year 1997–98. During this period, we'll be monitoring the program carefully to identify and resolve problems that arise. Once the system is fully implemented, a portion of the general cost savings from direct lending will be passed on to borrowers in the form of reduced interest rates on their loans. The bill reported out by the House Education and Labor Committee, and supported by the President, includes additional savings for students in terms of reduced origination and insurance fees.

The Department is taking steps to ensure that borrowers will continue to have access to as much loan capital as they have had in the past, with ample funds flowing to institutions in a timely fashion, based on borrower eligibility and needs.

Many schools can make—or "originate"—loans directly to students, although none will be required to do so under the President's proposal. In addition to certifying the eligibility of students and parents, providing loan counseling, and disbursing loans to borrowers, as schools do now, participating institutions would also execute the direct loan promissory note and maintain data on disbursement transactions. Schools that do not meet the strict criteria measuring administrative and financial capacity for loan origination, or that do not wish to originate loans, may use the services of alternative loan originators under contract to the Department at no cost to the institution.

To help defray administrative costs, the Department will pay a fee to those schools that originate loans themselves. For those schools that do not originate loans, the Department will secure the services of alternative loan originators, on a fee-for-service basis, under contract. If they wish to compete, these alternative loan originators could include state agencies, private lenders, the Student Loan Marketing Association (Sallie Mae), and other private organizations, if they demonstrate effective service and competitive rates.

Postsecondary institutions will not be responsible for servicing the loans while students are in school or while they are in repayment. Through a competitive bidding process, the Department will contract with a number of organizations to service these loans. Again the servicing and repayment contractors could include State agencies, Sallie Mae, and private firms, but this time on a competitive basis rather than an assumed yield as in the current program.

Under the direct lending program, repayment will be easier for borrowers because they can choose from a variety of repayment options, including fixed, graduated, or extended payment plans, as well as the new income-contingent repayment plan, which will allow students to enter lower paying community service jobs and pay off their loans as a percentage of their income over a longer period of time. For the first time, income-contingent repayment will be offered to all students. In addition, students will be able to switch payment plans as their financial circumstances change.

To make repayment easier and collection more effective, the proposed legislation would involve the Internal Revenue Service (IRS) in the collection of student loans. Starting in fiscal year 1994, the legislation would give the Secretary of Education the authority to offer income-contingent repayment to borrowers, using information from the IRS regarding borrowers' incomes. The legislation would also require the Secretaries of Education and the Treasury to develop a plan providing repayment options through the IRS and wage withholding.

As part of our stewardship responsibilities for the Federal student financial aid programs, the Department will oversee an orderly transition to the new direct lending program. Delivery of direct loan funds will use automated data and financial systems. To ensure high quality, we are redesigning our program integrity and monitoring efforts to focus on performance outcomes that will lead to increased accountability and efficiency. In addition, to ensure the availability of adequate loan capital, the proposed legislation will provide the Department with additional authorities to move quickly should capital shortages occur.

Some critics contend that we are moving away from a public-private partnership to more bureaucracy. This is not true. The Department will expand its partnership with the private sector through competitive contracts for alternative loan originators and servicers. These contractual arrangements will be designed to make much more effective use of the private sector than is the case with the current system, under which we must rely on private-sector participants who are paid based on a uniform rate set in statute, rather than market competition.

Through the Federal Direct Student Loan Program, we are reinventing government.

CONCLUSION

Let me conclude by saying that in one week alone, the Department received more than 2,000 letters concerning defaulted student loans and another 1,700 letters asking for information and clarification of provisions of the Federal Family Education Loan Program. These letters clearly illustrate the confusion and complexity inherent in the current program.

We believe we can better serve students and taxpayers by giving them a program that is simple, direct, less costly and less confusing. The Student Loan Reform Act of 1993 will start us down the road toward accomplishing those goals and will enable us to improve our service to our most important clients—America's students and taxpayers.

The **CHAIRMAN**. Thank you very much.

We'll try 5-minute rounds and then come back for second rounds if it is necessary.

We first want to express both the President's and Secretary Riley's appreciation for the initiatives which you have been providing in terms of management. It has been an absolute disaster over the period of recent years. We have not had any effective management in the Department of Education. I will not take the time to illustrate the various reports and monitoring, but it has been an absolute, uncategorical disaster.

So the fact that you are bringing in these kinds of techniques and good management skills is something which is just enormously, enormously important.

I would just say as a sidebar, because time is limited, you mentioned that people work at night and on the weekends. When my brother was Attorney General, and he used to go in on Saturday mornings, he would write down the license plate numbers of the people in the Justice Department. He then wrote them little notes, thanking them for serving. Then word got around the Justice Department, and people started coming downtown, parking their cars in there, and then going out to shop for the rest of the day or have lunch. [Laughter.] But I know that isn't true of the people you have in the Department of Education.

I think you understand very well the management challenges to implement the bill from last year and the pilot programs and to move in that direction. You will have the difficulties in the guaranteed loan programs as well as in the direction of the new programs. This is going to be enormously complex and difficult, I think.

Let me ask you, do we really need more than three programs in the direct loan program? You are going to have the subsidized loans for students, unsubsidized loans for students, and unsubsidized loans for parents. I think all of us are trying to make it, as you have pointed out, simpler, for the student, the taxpayer, and the university. I would be interested in your reaction to those three programs; should it be simpler in those areas?

Ms. KUNIN. Yes, Senator. When we first developed the legislation, we considered ways of possibly consolidating that and basically decided we wanted to look at that some more. But it is certainly something we would be happy to explore for further review, or work with you and your staff in looking at that.

The CHAIRMAN. We appreciate that, and would invite the members' recommendations and suggestions at that time.

One of the matters that has been brought up in the more recent debate is that direct lending programs make loans an entitlement to students rather than to banks. Is there any cause for concern about potential caps on entitlements?

Ms. KUNIN. No, there is not, but the same concerns would exist with the present program as with direct lending.

The CHAIRMAN. They could put the caps on the existing programs at the same time.

Ms. KUNIN. Exactly.

The CHAIRMAN. So that really should not be an issue.

Ms. KUNIN. It should not be an issue because we have created a system that says if you qualify, you are entitled to a loan, either subsidized or unsubsidized, and direct lending will not change that in any way.

The CHAIRMAN. I'll withhold my remaining questions.

Senator Kassebaum.

Senator KASSEBAUM. Thank you, Mr. Chairman.

Deputy Secretary Kunin, first let me say I have enormous respect for your abilities and your dedication to this issue. I think if it is to take place, it is in good hands. But I still have some real questions.

The first is the continual comment I hear about how this is going to benefit the students. I really don't know why, if it is to benefit the students, we just don't reduce the interest rate and have that reduction go immediately to the students.

Just as background, any excess profits in the current program, of course, can be attributed to the higher interest rates of Sallie Mae and the banks or lenders that are involved. And cutting the interest rate that lenders can charge for student loans would be a far more prudent way to approach this. By cutting the student interest rate under the current program, we could then benefit the students immediately instead of waiting for 5 years, as was proposed under the administration's direct lending legislation.

So I guess my question is if the purpose of the direct lending program is to benefit students, why not just cut the interest rate to students instead of giving savings to the Government?

Ms. KUNIN. Senator, that is certainly a very valid question, but we really have two missions here with this legislation. One is to capture the $4.3 billion in savings as part of the deficit retirement package. And because our proposal makes substantial savings over that once it is fully implemented, then we can give the student the benefit of reduced interest rates.

But I think you would have to make a choice, if you were going to give that benefit, between putting it toward deficit retirement or giving that to the student, if you were to implement it right away.

The difference between the alternative proposals and ours is basically that you do enjoy greater savings immediately. We, on the other hand, will enjoy greater benefits for the long-term. So it is a question of immediate or delayed gratification, I guess, in that regard, because we have a consistent, steady stream of savings of $2 billion after 1988, and none of the proposals that I have seen thus far can match that kind of savings.

But our view generally is the same, yes—part of it should go to the taxpayer, because basically the taxpayer has been overcharged. Certainly, the alternative proposals demonstrate that. But if that is the case, the Government should not continue to overcharge and should give some of that benefit back to the students.

Senator KASSEBAUM. Well, I agree, and again, I wish it would work, but I have grave reservations that by the fifth year, when supposedly the students will receive some benefits, we might find that the costs of the program are growing so dramatically to the Government that it isn't going to be possible to pass along those savings. I think that is the question mark, and I think it is misleading at this point to suggest that this is such a great benefit to the students because, as you say, it is predicated on savings being there in the future.

Ms. KUNIN. There will also, if I might add, Senator, be some immediate benefits to the students as well. One is in the repayment options. And again, you improved that situation somewhat last year by implementing income-sensitive repayment plans, but those are only up for 10 years, and the student still, from my experience, has to request these options. Here, it would be just automatic that you would be given those options for income contingency. And of course, that is the linkage with national service as well, because by going into an income-contingency, or EXEL account, as the legislation names it, you can have greater opportunity to serve your community by taking a lower-paying job and not being penalized in terms of your repayment plan.

And I would argue that a close analysis of our program does provide that simplicity. Not every State may be as fortunate as Vermont, where you know everybody, you know who your loan officer is, and you know the organization. With 7,000 or 8,000 lenders involved in this system, there is tremendous confusion and opportunity for simply not being able to get the information the student needs to know.

So I think simplicity, income-contingency repayment, and being able to reduce the interest rates—and I guess the overriding principle here is that this money should go to higher education in the long-term; it should not go to middlemen. It belongs to higher education.

Senator KASSEBAUM. Well, I think we would all agree to that, and income-contingent repayment is another aspect that I think is an interesting part of this debate.

I am about to run out of time, and I'd like to ask one more question. Regarding the role of Sallie Mae—and I am not here as a defender of Sallie Mae—but just as background, under the administration's proposal, the Department anticipates that many of the smaller community banks would get out of the program and sell their loans to Sallie Mae. The Department of Education also anticipates that Sallie Mae may be allowed to originate—which they have not been allowed to do under the current program—and service loans for the Department of Education. Thus Sallie Mae could emerge as a winner in terms of additional powers and responsibilities. Despite all that has been said about their excessive profits and salaries, isn't it true that Sallie Mae could possibly end up being a major player as the originator and continual servicer of these loans?

Ms. KUNIN. It is certainly true, Senator, that Sallie Mae could very well continue to be a participant, whether it be major, or whether it be in a new incarnation. There is a study within the legislation to determine the future of Sallie Mae, including the possibility of privatizing Sallie Mae. There is also reference to Sallie Mae in the transition period, that if there should be a shortage of capital, the Secretary could require Sallie Mae to be the lender of last resort.

Certainly, Sallie Mae has done an excellent job in many ways. The real question is are we, the taxpayers, getting it at the best price possible for our citizens.

Senator KASSEBAUM. Well, is there anything in the bill that would specifically cap the salaries of the Sallie Mae officers or prevent Sallie Mae from making significant profits under the direct lending approach?

Ms. KUNIN. We did not address that. Obviously, anything is possible, but we didn't feel that it was our prerogative to do that. Certainly, you are free to explore that.

Senator KASSEBAUM. Thank you.

The CHAIRMAN. Of course, they will only have a role on the basis of competitive position, as I understand the legislation.

Ms. KUNIN. That's right.

The CHAIRMAN. So if they have these higher salaries and other kinds of expenses, they are not going to be as competitive as another capable or able agency to deal with that. Am I correct in that understanding?

Ms. KUNIN. That is correct, although as a lender of last resort, they could be required by the Secretary to perform this function. Now, the law says they "may," and I think that has been changed to "shall." That is the only place that they would not be competitive. Their future is really up for study, and that is undetermined. If they went to be a participant in other parts of the program, that is correct, they would have to compete. Maybe that would take care of the salary question through that competitive process. I believe that was the undercurrent of our thinking. They do have economies of scale, of course, that some of the other groups do not.

The CHAIRMAN. Senator Pell.

Senator PELL. Thank you, Mr. Chairman. My regard for you and for the Secretary is of the highest order, but for this legislation, not quite so high. [Laughter.]

Ms. KUNIN. Maybe some of it will rub off.

Senator PELL. I share the concern of Senator Simon and Senator Kassebaum for the bloated salaries, which is poor public relations at the least, and would hope that hearings like this might produce a change of habit.

One of the things that I am most concerned with is from a philosophical viewpoint. I have always believed that the more that private industry or private sources do, the better, and that we should move away from Government to private sources. Here, we have a case where we are going in the opposite direction. It is working, just like the one-horse chaise used to work, but we are moving from private industry into more massive Government. I may sound like a Republican, and I am not, but I do believe that that is a philosophical error, and the effort should be to try to improve private industry, but not knock it out for Government.

Obviously, in politics, compromise is what makes it go round. That is why I disagree at times with my own party and others when they say, "We will not go a foot beyond this line," and draw a line in the sand. In this case, you can see that there is some unhappiness and unrest on this proposal.

One possible compromise might be the idea of having a stopping point in the phase-in at which we would look at where we are going and make a specific decision on whether or not to proceed to a full-blown program. I was wondering if that thought might have any merit.

Ms. KUNIN. Let me first return your compliment and say I have the highest respect for you and the Pell Grant Program that bears your name, which has served so many students very, very significantly. And I know you have been engaged in these issues and bring a wealth of experience to your question as well as your point of view.

Senator PELL. Thank you.

Ms. KUNIN. Whether or not we would pause, or the legislation should say that in a specific way, I would like to give some further consideration. Let me give you my sort of common sense answer.

Obviously, if we see that there are problems in the program, we will pause, and we will ask for greater time in order to implement it properly and at an appropriate pace. The last thing in the world we want to do is jeopardize in any way access to loans for students. Also, I think the legislation says we will report to you annually. We would be happy to report to you monthly, if that would be of assistance, to keep you as fully apprised as to both the progress and the problems.

I think one of the fears that people have about a program is that you only know about the problems when it is too late to fix them, and as a former Governor, I know you can't live that way; that you have to have the bad news come to you soon so that it can be turned around, and that is how we would run this program.

But we certainly would be open to giving thorough review to any suggestions you might have in that regard and welcome that very much.

Senator **PELL**. Why do you think we should not wait for the results of the pilot program itself before engaging in this dismantling program? What would happen if we waited a couple of years? I gather we would lose some money. And I would like to follow that question up with another one: Would that money that is saved be cross-walked for other student programs, or would it go into the general pot?

Ms. **KUNIN**. Let me try to answer both of those questions. The first question was why not do the pilot full-blown before—I would substitute the word "dismantling" for "creating"—the new program of direct lending. I guess you are right—one is the money, but it is not the only reason. Second is that it would take us so long. You couldn't just go through the period when students were still in school, those 4 years; you would really have to test it also once they are out of school, and you are collecting the loans. So you would need at least 8 or 10 years to get any results.

The other problem is that at 4 percent, you don't have the economies of scale to really test the extent of the savings, so that it would delay the savings, but it would also not give us the kind of information that we need. So people would be back in this chamber, saying, "Hey, we didn't really test; we didn't really get the answers we needed."

The other reality is that some schools would be reluctant to enter a pilot program that may or may not become the policy of the country in the long-term, and they might be hesitant and ask do we want to be the guinea pigs in a program that may not exist in a couple of years.

So I think the substitute proposal of phasing in in a prudent way is really a similar concept as pilot, but it allows you to correct as you move.

There is little argument that we can—I have to modify my assumption that there is little argument—but there is a lot of evidence that the savings are there, and we are very confident in that evidence. So the real question is how do you construct the system; how do you do the details and the technical parts to really make it work well. And that part, we can build up through a phase-in process at the pace that we think is workable. If it isn't, we will be happy to reconsider, slow it down, change it, and make sure that it does work.

Basically, we have said we think we want to get there from here, as we say in Vermont, and we want to get there in the most appropriate, shortest, but also most careful way possible.

Senator **PELL**. Actually, as you know, it is only 4 percent in the first year in the present program.

Ms. **KUNIN**. That's right.

Senator PELL. So I guess basically my concern remains about the creation of another pretty massive Government bureaucracy, and that causes me to have more hesitation than any other factor.

Thank you very much.

The CHAIRMAN. Senator Jeffords.

Senator JEFFORDS. Thank you, Madam Secretary. It is a pleasure to have you here. I am very grateful for the work you have done and for the excellent statement you have made.

I want to pursue Senator Pell's line of questioning to this extent. It seems to me we could have a win-win situation if we were to take the advice of Senator Kassebaum on reforming the present program, because we would save more money in the early period and phase in the plan more slowly. Then with direct lending, which I hope will become the program, we would get more savings in the later years. But in the meantime, we would have an easier time. I would say if we speed it up—go to 8 percent or so—and then phase in the pilot program, but not as extensively as you would, it seems to me we might get a win-win situation as well as discern the difficulties and problems that we are going to have with the program.

In my own experience down here, I have rarely, if ever, seen the Federal Government administer more efficiently than the States. And right now, we are pretty much in agreement that we are going to unravel Medicare because its administration is a disaster, so we have to reform it.

So first of all, I think we could have a win-win situation if we were to utilize the thoughtful suggestions of Senator Kassebaum, I think concurred with by Senator Pell, and perhaps expand the pilot program, without getting into a position where we can't retreat. And my second concern is why are we not utilizing present administrative resources, such as VSAC in Vermont, and not at least giving them an opportunity or making it possible for them to take over the administration aspects?

We are all familiar with our own States, and in Vermont, VSAC does everything now with the exception of some of the loans which one bank takes care of. If you were just to substitute the direct lending pilot program for the existing loan program, it would be a quick changeover. The students would still have the same people to deal with, and there would be no change other than the title on the loans. Whereas if you go with the proposal before us, which doesn't seem to give any opportunity for that to occur other than perhaps under some competitive position, it seems to me you are unnecessarily complicating this situation for students.

I'd appreciate your comments.

Ms. KUNIN. Yes, Senator. As far as VSAC, you and I are both familiar with that organization, and basically, VSAC would be a very strong competitor in this system. But the difference between the current program and direct lending would be that they would have to compete. So the question would be can they meet the competition. Very likely—we can't guarantee that, of course—they may. And not only could they possible serve Vermont, they could possibly serve a wider constituency because we would have fewer contractors than under the present system.

So I think this will be somewhat Darwinian. The fittest will survive, the leanest will do best, and the most efficient will stay in business, maybe under somewhat new functions. Their functions may be changed because the whole need for guarantee obviously would not be there. But they could be the lender. That's one possibility.

As far as your earlier question, can we have a win-win situation, certainly we are open to looking at any proposal and giving it our careful analysis. But we adhere to our preliminary conclusion that if you simply go with the pilot, if you simply squeeze out the profits, we are going to be back next year with the same discussion, and we won't really have the kind of long-term structural change, long-term steady-state stream of savings, that will benefit students and will benefit the taxpayer.

Senator JEFFORDS. Just one comment on VSAC. Maybe Sallie Mae will come in with a bid of $9 to serve alone, and VSAC is at $10, and Sallie Mae gets it, so all of our students have to deal with somebody somewhere else. So the Government may save a buck, but the students lose a tremendous opportunity that they have now to have something right at hand that they can deal with. And I don't think there is anything in your competitive system which is going to compensate for the inconvenience to students.

Thank you, Mr. Chairman.

Ms. KUNIN. I would just add, Senator, that as we envision the system, there would be offices or representatives—I mean, we really live in a national and international economy now, and of course their loans could be held in banks all over the country at the present time as well. But thank you. I will take that into consideration.

Senator JEFFORDS. Thank you, Mr. Chairman.

The CHAIRMAN. I agree. In Boston, when you call the airport in terms of reservations or schedule, it goes out to Minnesota, just in terms of when the plane is arriving, when it is leaving—I don't know whether it's any better if any of you have tried to get a reservation in Boston recently.

Senator Simon.

Senator SIMON. Thank you.

First, Madam Secretary, you held up one chart from the GAO report on how the present system works. This is their chart. This is not Paul Simon's chart or Madeleine Kunin's chart. This is how the GAO shows the direct loan system. It is clearly a much simpler process than the one that we now have.

Again, you mentioned this, but there are still colleges and universities that think this is going to shift the cost. They have been told this by Sallie Mae, by the guarantee agencies. It is interesting that the colleges and universities who have really studied it are calling in and saying, "We want to be part of the pilot project."

Can you reiterate again—what assurance does a small college in Nebraska or Illinois or Massachusetts have that this is not going to shift the cost?

Ms. KUNIN. Thank you, Senator. I would be happy to describe that, because our group that developed this legislation spent a lot of time making certain that we don't impose any undue burden on colleges. We listened to a lot of points of view and reports and got a lot of input in that regard.

First of all, nobody has to do direct ending. It is not compulsory. If you don't want to get into this business, if you don't want to take it out, fine. We will provide, through the competitive process, an alternative lender to do that work at no cost to the college.

If you do want to do it, and if we think you are capable of doing it—there will still be a screening process because we don't want institutions who have a shoddy track record already to get into the business of dolling out loans—but if you are capable and want to, you will be paid a fee, and the bill says it will be a $10 fee.

Now, there is a lot of argument or debate or different points of view as to what will be the burden, and will that fee be adequate to pay for the process. Our analysis basically says in some ways, yes, there will be additional responsibilities. There will be some responsibilities in terms of signing a promissory note, reconciling the disbursements, and making sure that the student is in fact in college, and verifying that each year. But the loan officer will also lose some responsibilities of not having to deal with 7,800 banks and 46 guarantee agencies.

So for most schools, it will probably be a wash, but obviously we need some more experience with some of the smaller schools to really hold up your right hand and swear that on the Bible. But our analysis from the institutions we have looked at makes us very comfortable with that conclusion, that the $10 fee will cover most of the costs because they will have some reduced responsibilities as well as some increased responsibilities. But in no way should this lead to tuition increases or burdensome administrative costs.

The colleges also will have an advantage. They will know what their students are doing. They will be better advisors because everything will be centralized in that one loan portfolio. So it really creates a much more rational system both for the student and for the institution.

Senator SIMON. I talked to a reporter yesterday who called me about the press conference we were at yesterday, and she said, "I can't keep track of who holds my loan." And that is true——

Ms. KUNIN. It will be one-stop shopping in that sense.

Senator SIMON. I have 2 minutes left, and let me suggest—and Senator Kassebaum, if I may have your attention—I think if we go ahead with the administration's proposal, I think we also ought to look at Senator Kassebaum's suggestion of reducing the fees under the rest of the program. Every report including CRS says these are excessive profits right now. And if we could take some of that money that we now give to the lending institutions and shift it into Pell Grants, I think we ought to be looking at that. I am not asking for an answer right now.

Ms. KUNIN. Well, let me just comment on that, Senator.

Senator SIMON. Briefly.

Ms. KUNIN. Briefly, because I don't want to take away from your 2 minutes. But we looked at that, and basically, we wanted a smooth transition, and we feared that if we did both, if we moved to direct lending and reduced the fees in the current guaranteed student loan program, some people might pull out, and that would give them a reason to pull out and really disrupt the system. So we really wanted to make sure that we gave absolutely no avenues of escape, if you will, if possible, so that we would have a smooth transition, and nobody would be calling you at your office, saying, "I can't get a loan."

Senator SIMON. Finally, there has been some concern expressed about Sallie Mae and their future. I think that eventually they ought to be privatized, and then let them compete for these things. They have very substantial profits they are making right now. And then, if they want to go into some other business—printing college textbooks or running bowling alleys or whatever they want to do—let them get into whatever business they want.

And let me just add my thanks to you. I think you are doing a great job as deputy secretary, and I think the Nation is well-served by the combination of you and Dick Riley over there.

Ms. KUNIN. Thank you. We consider it a great honor to serve.

Senator SIMON. Thank you, Mr. Chairman.

The CHAIRMAN. If I could take just a moment, you are hearing about how much is actually going to be returned to the student, coming from different angles, and of course, this is against a background where the administration is cutting back on the work-study programs and other student support programs in the budget. These are benefits that go to the sons and daughters of workers. It is a matter of concern, certainly to me and I know to a number of other members of this committee who are supporting the program, that we see the benefits, when at the same time you are cutting back on students who are involved in other programs. So in developing some kind of general consensus, if that is what we are all interested in, I think we are going to have to work out some of these matters, and we want to work with the administration on that. I am strongly committed to what you are trying to do, but I think you are seeing how much this is going to go to the students.

We have been hearing a great deal around here—and I don't aim this at my colleagues here, because all of them have been strongly committed in terms of education programs—here, we have a very modest program to try to do something for the taxpayers in deficit reduction, and we have the administration getting whipsawed about that aspect of it as they are trying to pass some of the benefits on to the students. So I hear you, and I know where you are coming from on this, and I think the education program and the deficit program have to be balanced, but clearly this program will benefit the students in an important way. I think many of us on this committee would like to go a lot further than where you are moving on it, but nonetheless we want you to know that we understand the awkward position that you are put in at this particular time, and we are still supportive.

Senator Gregg.

Senator GREGG. Thank you, Senator.

Governor, I guess I really don't understand some parts of this, and maybe you could run through it for me. Is the plan under this proposal to definitely use the IRS withholding capacity to collect the loans once a student completes his education and is paying off his loan? Will each student's loan then be collected through a withholding process?

Ms. KUNIN. No. I am glad you raise that question because I did not have an opportunity to go into that area. What the legislation says is that for now, the IRS will share income information with the Department of Education, so that we can verify income in order to do the income contingency plan, because in past efforts to do that, a major problem was how do you prove the income. So the IRS' cooperation—under carefully circumstances, obviously, to keep it constitutional—is very important in going into income contingency.

The second reference to the IRS is that there will be a 6-month study between the Secretary of the Treasury and the Secretary of Education to see how the IRS could be involved in collecting loans, possibly through wage withholding or other methods. It is likely that the IRS will be involved in income-contingency loan collection, but that has not been determined by this legislation.

Senator GREGG. Well, I notice that in section 6306, it does authorize, I guess—it says, "upon determination by the President under section 457(c)(2), concerning the implementation of a plan of repayment, Federal direct student loans through wage withholding or other means by the IRS, the Secretary of Treasury may enter into an agreement with the Secretary of Education to pursue that." So the authority is here for you folks to use withholding to collect on loans, but it is not your plan to do that? I am not opposed to that. I think that's a good idea. I think the key to getting the whole student loan program under control is to get the defaults under control so that we can lend that money out. That is the way to increase the pool, and it is not fair that the pool is being reduced by people who aren't repaying. And I am just wondering how enthusiastic the Department is for pursuing withholding. I am enthusiastic for that.

Ms. KUNIN. We are also enthusiastic, because there are really two parameters to the student loan program. One is expanding opportunity, but the other is also clearly defining responsibility, that you should have access to a student loan if you are eligible, but you should clearly understand your responsibility to pay it back. And we believe that the involvement of the IRS will strengthen that sense of responsibility.

The reason it is not saying we are going to start this tomorrow is that we want to make sure we know how to do it right. The IRS has to gear up to do it, has to develop computer programs. We have had various discussions with the IRS around the table. But I can say at this point that they are very cooperative, and I think, while some people may look at the IRS as an onerous presence, we really see it as a positive presence, making the rules clear from the start. And wage withholding could be seen by many as a convenient way to pay back their loans rather than as a Draconian method.

Whether the IRS will ever be further involved beyond income contingency in all loan collection, that again is open to study. But the reason for the study is simply to do it correctly.

Senator GREGG. Now, what happens when the student gets out of school and has a job—maybe they are being withheld, maybe you decided to do a withholding process, maybe not—but in any event, they have a problem, which is so typical—there are 230 million problems in this country that people have—with their repayment structure. Whom do they call? They can no longer call the school, I presume, even though the school may have been the administrator that initiated the loan, or maybe it was some other competitive group that won the bid. Whom do they call when they are 27 years old, and they have a problem, and they want to talk to somebody about their loan?

Ms. KUNIN. Well, presumably they will have developed a relationship with the servicer who is handling their loan, and that is the person that they will call. We will also have—as we have now, but we will have much greater capacity to respond to it—within the Department of Education an 800 number. But their first call would be to the person who is handling their loan at the present time.

Senator GREGG. Then, do you anticipate, for example, if UVM were the administrator, that they would track that loan continually after the student was out of school?

Ms. KUNIN. No. The university or any postsecondary school responsibility is only for originating the loan and then verifying that the student is actually in school and reconciling the disbursement. It is not for collecting the loan. The collection part would be turned over to a contractor, which could be anyone of these entities through the competitive process—it could be a bank, it could be a guarantee agency reconfigured——

Senator GREGG. And are those going to be regionally chosen, so that they have some relationship to the physical location of the student, or are they going to be nationally chosen?

Ms. KUNIN. Well, I don't know if it will be like Logan Airport or not, but certainly they would have to have onsite representatives and offices to make that servicing——

Senator GREGG. When you say "onsite," do you mean in the physical region, or—let's take a hypothetical. A person graduated from Vermont, he stayed in Vermont, he is working in Vermont. Where does he go when he wants to meet somebody to talk about the fact that he can't pay is loan back?

Ms. KUNIN. It is hard to give you the details on that until we really see how the competition sorts itself out. We anticipate at this point roughly 10 or 12 or 15 contractors that would meet the competitive bidding process and would be disbursed regionally around the country. But we will also obviously consult with you in terms of making sure that those are appropriately placed.

Let me turn to Maureen McLaughlin and see if she has any further details to add to that.

Ms. MCLAUGHLIN. I guess that in the beginning, we'll start out with one contractor, as the program is small, and then we will expand the number of contractors. So initially, we would have one contractor handling the first number of students, and then we would expand it, and we probably would do it regionally as we expanded it.

Senator GREGG. OK. I think that's going to be a problem for a lot of folks. I think we have got to have somebody that people can go to. I just sense that that is going to be a problem.

The CHAIRMAN. You will work with us in terms of developing language or legislation to try to deal with these regional kinds of questions.

Ms. KUNIN. Absolutely, absolutely.

The **CHAIRMAN**. I think that's a very legitimate issue. There are rural areas, urban areas. I think we would be enormously interested in trying to deal with that issue.

Ms. **KUNIN**. Absolutely, Senator.

The **CHAIRMAN**. I think it is a very important and reasonable one. At the present time, we know what a morass it is, and we believe that this program will be more responsive, but I think it probably ought to be outlined to have an input in working with you on this.

Ms. **KUNIN**. Yes. Senator Gregg raises a very important issue, and I think it is one that we will pay very close attention to and certainly will be open to suggestions. The only parallel I can think of at the moment—and it also has its pluses and minuses—is interstate banking, and I think we can learn from that experience as well, that when you make something on a national scale, you obviously do have to have the local face to attach to it, not just the computer. And we will take that into consideration in the design of this.

The **CHAIRMAN**. The question of the IRS role has been made, and let me just say that in the House language, they lean toward the IRS, and I think most of us are probably in agreement, but it is going to require additional legislation before that becomes the instrument. So again, it seems to be a reasonable way to proceed with some caution, but nonetheless to try to explore that in greater detail.

Senator **GREGG**. Mr. Chairman, can I ask a follow-up? Did I misunderstand? I thought Chairman Ford in the House took a pretty strong position against using IRS. Am I wrong on that?

The **CHAIRMAN**. Well, the language——

Senator **GREGG**. The bill has some authorizing langauge.

The **CHAIRMAN**. I am not prepared to speak for him, but I am informed that they had language that the IRS cannot be involved in any loans until the Congress authorizes the activity.

Ms. **KUNIN**. The reason for that, Senator, was because at first, we designed the legislation so we did not have to come back to the Ways and Means Committee for reauthorization. They wanted to make sure that we did come back. It is not in opposition to the IRS. My understanding is that Chairman Ford is very supportive.

The **CHAIRMAN**. There are jurisdictional issues, as there would be in this committee, but it isn't out of denial—we'll work both with the Ways and Means, and the Finance Committee, and the administration on this.

Senator Simon.

Senator **SIMON**. I would just underscore what Senator Kennedy said, that there is a jurisdictional problem in the House, and this is the reason for the language in the House. They don't want to get knotted up with too many committees.

Senator **GREGG**. I have never heard of that happening in the House. [Laughter.]

Senator **SIMON**. And I might add that in Australia, they have their counterpart to the IRS collecting, and the system is working very well.

The **CHAIRMAN**. Thank you very much.

Senator Durenberger.

Senator DURENBERGER. Mr. Chairman, in health care reform, we have 44 legislative committees and subcommittees that whatever that thing that comes out of the White House is going to have to go through, and if we think that thing is going to pass in a couple months after this particular illustration of what gets in the way of doing good, you really have to keep your fingers crossed—which gets me to the point that one of the things I have learned watching the White House operation on health care reform work is that in economics, it is really important that form follow function. And the debate that we keep missing here is the function issue.

All of this talk is about form—trading off one part of the process for another part of the process. The whole thing is process-oriented, and it seems to be so difficult to get back to what is the function that we are trying to facilitate here.

At the rate I've got it figured, my friend John Schullo is going to get on about 1:15, and I am going to disappear at 12:30 because I am holding a luncheon for a bunch of my colleagues. So I want to make a couple of points, in case anybody else disappears, that John will make that relate to this issue.

There are three things he wants to say about direct lending. First, students feel caught in a Government "sting" operation with regard to loans. They must take them to remain in school. But the realities of their futures are geography, family history, crime rate, divorce rate, personality of the borrower, low wages of entry-level positions, all of these kinds of things that affect the ability to repay.

Then he says, "My point is that any loan program which uses as collateral the academic progress and potential earnings of the borrower must either accept a high default rate on those loans or establish repayment options which address the default problem." That seems to me to sort of zero in on the two courses—and I am not getting into the banks versus anybody else on this, but just in making public policy.

"To put it another way, some students have a choice—loan or no school. When they graduate or leave school, they also have a choice—pay or default. When real life problems occur it is survival or default." That is the reality for most of the people that we know.

"It seems to me that the Government has no business loaning money out on the basis of potential earnings without either accepting a greater risk at the repayment end or providing repayment choices which help students through life's problems."

If I am to try to capture in one person's picture of this after some years that John has been in this business, that says what the function is and what this is all about.

He makes two other comments. "Students are frustrated by the fact that someone is making a profit off of them." And third, "Students are frustrated with the complex and confusing repayment process." But that first one is the critical one.

I have just one question which relates to why did the administration move in the direction of different repayment options. In our bill, we had a single repayment option. You have flexibility in offering an umber of different options. And I would just express my concern—not speaking for Paul—but what concern might you have that the number of repayment options is going to result in what, over in the health care area, we call "adverse selection," in other words, a disproportionate number of low-income borrowers choose the income-contingent option, and the higher-income don't, and then you put the solvency of the program in jeopardy.

Ms. KUNIN. Well, Senator, I am glad you asked. Actually, John's comments really relate to the answer, because I think giving students options answers the question what happens if the circumstances of your life change—is the only option that you go into default? Our answer is no; we should be able to accommodate that, recognizing that this might be a short-term crisis, and a year from now you'll have a job and be able to be in full repayment again. So that the income-contingency, or the deferred payment or the flexible payment allows us to avoid default and continue to collect money so that we don't write this student off and immediately put that student into default.

As far as how many students will choose what option, our best estimate right now is that income-contingency would be selected by approximately 15 percent of the students. As to what the cost of that would be, we see it as a wash. You would have some increased costs, obviously, in stretching out the loan and servicing that loan and all the administrative needs that go with that, but you would also have some savings in that you would eventually get paid, and even if you get paid $10 a week, it's better than getting paid nothing. So that is an advantage.

And two, there would be interest charged on that, so it isn't like you are getting a free ride. The hard part is when do you cut it off. Do you say you are going to go to your grave owing your student loan after 40 years. So there is a provision in the bill that says the Secretary will make some designation as to when you call it quits and you are forgiven. One possibility is around 25 years or so.

Senator DURENBERGER. Thank you.

The CHAIRMAN. Senator Coats.

Senator COATS. I have just two questions, Mr. Chairman.

One, I am very concerned about one of the myths that you discussed and that it might not be a myth, and that is that students' access to loans might be jeopardized in the future, because clearly, we are going to public capital instead of private capital by going to direct lending and Federal borrowing. Given the budgetary pressures that we see and the political responses that we see already—in fact, the very reason that we are talking about this $4.3 billion is that the budget committee has ordered us to find the savings. So we are doing that by this shifting from indirect to direct lending.

But I just wonder what we are going to do next year, when the budget committee says we need another $4.3 billion from this committee. That is going to put additional pressure on us to find a way to enact savings across the board.

So we are going to be balancing, then, the needs of students and looking at the various programs that the committee authorizes and administers. You had indicated that the direct Government lending would not jeopardize the availability of funds, but it is my understanding that just yesterday the administration froze $72.5 million in Federal/State student incentive grants, apparently because the

President made a decision to use that money for the summer jobs program. So the SSIG money, which was transmitted to States as a source of aid for needy students, is now going to be used for another program. My understanding is that a couple of States, Oregon and Kentucky, had already sent out award announcements, and now the are going to have to contact those students and say, whoops, the money isn't here.

My concern relative to this program is that a year from now or 2 years from now, we are going to be sitting here saying, the money isn't here for the Pell Grants, and we have to divide it up. We have a limited amount of money. We have these demands from the student loan program, we have these demands for SSIG, we have these demands for Pell Grants, these demands for student loans, etc. We are going to have to do it across the board. We are going to have to have a reduction. I think the Pell Grant Program already is $2 billion short-funded.

It seems to me that we are putting a lot of pressure on the system to deliver, and that we are going to have a problem raising the public capital. We'll raise it, but we'll have to raise interest rates to raise it, which change the assumptions, which change the savings, which force us to come back and find more savings, etc. And I just wonder if that is not a real concern.

Ms. KUNIN. I certainly appreciate your concern, Senator, and I am glad you raise it. Let me just respond to your first point that the President froze some funding. That was the House committee that took that action, not the President.

But there are really two different kinds of issues implied in your question——

Senator COATS. Well, it was in response to the President's summer jobs program because the White House wanted the money available for the summer jobs program—which is a legitimate request—I mean, the money is limited, and we have to get it from somewhere.

The CHAIRMAN. It is amazing to me to hear that now, after we have gone down this road with the stimulus program and so on to have a summer jobs program. As I understand it, the President would have taken a percentage cut, but the appropriators wouldn't do it. The President would have taken an emergency, but the Congress wouldn't do it. So before we try to nail the President on this——

Senator COATS. No, I am not trying to nail the President, Mr. Chairman. I am just simply stating that the pressure on the capital in terms of Federal——

Ms. KUNIN. I understand, so maybe we should get back to that larger question. This is, for all intents, an entitlement program now, and it will be under direct lending as well. It increases the debt, but it reduces the deficit. So if one follows that logic, there really should be less pressure on the budget for those kinds of cuts that you fear, than more.

And just to reinforce the commitment of this administration to such programs as Pell Grants, as I am sure you are aware, we inherited a $2 billion deficit in the Pell Grant Program. Secretary Riley and I were both surprised to find that little envelope tucked in the drawer when we walked into the office, with this I.O.U., and we decided right off, and the administration strongly supported this, to wipe that slate clean and get off to a real solid start on Pell Grants. That, again, was part of the stimulus. It is now being reincarnated in the House as an amendment to the 1994 Budget Act. So we hope that once again, Pell will be on solid footing. [Laughter.]

Senator COATS. I am sure Senator Pell is very happy to hear that, also.

Ms. KUNIN. Do you feel better, Senator Pell? [Laughter.]

Senator COATS. I just see a lot of competing pressures for it, but I guess that transitions into my second and last question, and that is that the whole idea is premised on eliminating the cost savings derived from eliminating the middleman. And yet you have discussed a whole number of ways in which colleges and universities can avoid the administrative costs by saying, "We don't want this," or "We can't handle this. We are too small," or it is too cumbersome, or whatever, and then DoE is going to have to contract out. Well, when you contract out, you are simply establishing a new middleman, and you have to pay that middleman, and it seems to me you are just substituting one for the other.

You also talked about the collection and going to a collection agency. That's a middleman.

So it seems to me that there are some questions about how direct this direct lending program is and whether or not we are just simply substituting one set of administrative costs for another set of administrative costs, particularly in light of the fact that the current administrators have now come forward and said, "We realize we have to lower costs, and here is our proposal on it."

Ms. KUNIN. Let me answer that this way. We are injecting a good old-fashioned concept called "competition" into the system, and that really will reduce what everybody now agrees we can call excess profits. The pure administrative costs, if you take away the excess profits, will be about the same; but removing the excess profits makes a major difference.

The other reason for savings is the simple fact, that I think is generally accepted, that the Federal Government simply can borrow money, can issue securities more cheaply than can the private sector. We have certainly proven that again and again, that we do that very well, and we can do it at a lower rate, and that's where the lion's share of the savings comes in.

But you are absolutely right, we have to administer this well; we have to administer this well. We have to make sure that those administrative savings are there in terms of reducing the excess profits, and we have to make sure that our ability to administer is not eroded, because that is one of the areas where the budget could be cut, and we are going to be very adamant that in order to do this program right and serve the American people well, we have to have the capacity to do the job.

Senator COATS. Well, I thank you for your testimony.

Mr. Chairman, this is a good hearing, and we are getting a lot of good facts on the table here. I apologize also for not being able to stay because I am one of the guests at Senator Durenberger's lunch.

The CHAIRMAN. Senator Simon.

Senator SIMON. Mr. Chairman, just a couple of very brief comments. One, that option was put in for the colleges and universities because they had been hearing these horror stories. In fact, colleges, instead of having to deal with 560 lending institutions, the whole thing is going to be much simpler for them, and I don't think you are going to find many of them using that.

Second, to the question about the benefit to students, when Senator Durenberger and I originally introduced the bill, for the level up to the cost of attendance for freshmen and sophomores, you could borrow $6,000; for juniors and seniors, $8,000; and for those in graduate school, $11,000 to $30,000. That was pared down because we said as a demonstration it would be unfair to the present program if you compared the two, because everybody would want to get into this other program.

But if in fact CBO is correct that this will not only pay for itself and eliminate the problem of student loan defaults, we can appreciably increase the amount of assistance that students receive, so there will long-term be a great deal of additional assistance to students.

Ms. KUNIN. If I might, Senator, just add that even if every school were to choose not to do loan origination, and we would provide an alternative originator, it would only cost some $200 million over 5 years. So this is not a major administrative expense.

The CHAIRMAN. We thank you very much. I would hope that all those on both sides of the aisle will continue to have inquiries. We want to work closely with you. A number of issues have been raised, and we'll do our best to work with the committee members and also with the administration on the program.

We thank you very, very much. It has been a very informative presentation, as always, and we are delighted to have you before the committee and look forward to working with you.

Thank you very much.

Ms. KUNIN. Thank you very much, Senator. We appreciate all the excellent and probing questions, and if you have further questions, please call on us at any time; we'll be pleased to respond.

The CHAIRMAN. Thank you very much.

Our first panel this morning is a very distinguished group of representatives from the higher education community, including students and college presidents.

I am proud to introduce Father Bartley MacPhaidin, president of Stonehill College in North Easton, MA, a small liberal arts college. Father MacPhaidin was born in County Donegal in Ireland. We are pleased to have him with us. He has been a dear and valued friend to me, and has been enormously creative in terms of outreach programs. He developed one of the first student exchange programs in the Soviet Union, and is very much involved as a university in assisting many of the schools in Boston that are dealing with difficult racial issues. Stonehill was one of the first colleges in the country to institute student literacy programs. It is a real pleasure to have him here.

We welcome also Aisha Satterwhite, a student from Washington, DC. She is a junior at Clark University in Worcester, MA. Ms. Satterwhite has had several problems with her loans and will share these experiences with us this morning.

J.L. Nelson is a junior at Iowa State University. I am sure Senator Harkin would want me to extend a warm welcome to you. The father of three small children, Mr. Nelson has substantial student debt, and he will give us some first-hand insights into the problems with guaranteed student loans.

The third student we will hear from today is Robert Kraig, a Ph.D. candidate at the University of Wisconsin. Mr. Kraig has had problems dealing with this loans as well.

We'll start off with Father MacPhaidin.

STATEMENTS OF FATHER BARTLEY MACPHAIDIN, PRESIDENT, STONEHILL COLLEGE, NORTH EASTON, MA; LLOYD V. HACKLEY, CHANCELLOR, FAYETTEVILLE STATE UNIVERSITY, FAYETTEVILLE, NC; AISHA SATTERWHITE, STUDENT, CLARK UNIVERSITY, WORCESTER, MA; J.L. NELSON, STUDENT, IOWA STATE UNIVERSITY, AMES, IA; AND ROBERT KRAIG, STUDENT, UNIVERSITY OF WISCONSIN, MADISON, WI

Rev. MACPHAIDIN. Senator Kennedy and members of the committee, I appreciate very much the foregoing discussion. I think I got a quick education in a few hours.

My name is Bartley MacPhaidin. I am president of Stonehill College in North Easton, MA. I especially appreciate the opportunity of appearing before this Committee on Labor and Human Resources to testify in favor of the President's proposal to transform the Federal Family Education Loan Programs from the present system into direct lending.

Stonehill College is a good example of a private comprehensive institution, with 3,000 students, who financed their way through a variety of financial aid and work programs—Pell Grants, supplemental grants, and work-study, programs which were championed by this committee and its chairman, provide our college with about $715,000. There is a further $200,000 in Perkins loans which is made directly by our financial aid office.

Now, since their inception in the 1960's, Federal student aid loans have played a vital role in opening the doors of college to millions of Americans. At Stonehill College today, Stafford, SLS and PLUS loans to our students during the past year totalled $3.9 million.

The total of all this Federal financial aid at a school like Stonehill is nearly $5 million, or 16 percent of our annual operating budget. Our students could not finance their education without these programs, and the loans are the largest single element. Stonehill would be very different without those programs. I take the opportunity on behalf of our students and their families, Mr. Chairman, to thank you and the members of this committee for your help with student aid in years gone past.

Our support of direct lending as an alternative to the present system is not a position that we have taken casually. We have thought about it seriously, and our financial aid office has thoroughly reviewed its implications for our students and our institution.

An important ground of our support for an alternative to the present system is that it is not understood. Our students do not understand it while they are in college, and with changes in bank ownership, sale of loans in the secondary market, changes in servicing agencies, they certainly don't understand it as alumni.

One of our older, nontraditional students in fact wrote a paper last year about her frustrations with snarls in her student loan accounts, and I will send that along to the committee later on.

Of some importance to me is the fact that my financial aid staff must go each year to several seminars or workshops to keep abreast of changes in the system. And finally, I confess myself that I have little understanding of the present system.

Despite incremental reforms over the years, the complexity of the system constitutes perplexity and frustration for students, their families and for administrators. This complexity contributes to higher than expected default rates, avoidable administrative costs, and widespread concern about the basic stability of a system which constantly needs so much adjusting.

Last year in the reauthorization act, Congress took an important step in improving a demonstration program for direct lending. The President now proposes that this streamlined and cost saving system be fully phased in over the next few years, and we support that change.

We support it because what we need in financial aid above all are programs which are simple, coherent and comprehensible. The present loan programs cannot be described in those terms, and indeed, their complexity, incoherence and incomprehensibility to lay people increase each year with each cycle of fine tuning.

I would like to address the one charge—and you have heard many charges—but the one charge you have heard that many colleges will not be competent to carry out their role in this process. I do not suppose that Stonehill College is a household name for most of your colleagues, Mr. Chairman, but we are fairly typical. We are not Ivy League, we are not ancient, we are not big, we are not rich, we are not research, and we are not old. As a matter of fact, we were founded from the University of Notre Dame less than 50 years ago, and if Senator Coats were still here, I would reiterate the remark that Governor Kunin made that even though the financial aid director at Notre Dame is in favor of the present system, its president, Father Malloy, is in favor of direct lending.

At Stonehill, the president and the financial aid director are on the same line.

The CHAIRMAN. How did you line them up? [Laughter.] I think I know.

Rev. MACPHAIDIN. A house divided shall not stand.

But we are a good, comprehensive college where, last week, 499 students graduated to start their lives and their contributions to our society.

Stonehill, along with almost all 4-year colleges in Massachusetts, and most 2-year schools as well, already makes Perkins loans, a direct loan program in which default rates are uniformly at low levels. And we process Pell grants, not the simplest administrative task in our operations.

It is clear that if a college can carry out the functions of the Perkins loans and Pell grants, it can carry out its responsibilities for direct lending in a responsible manner.

I am not a contentious person by nature, and it is probably bad form to do this, but it is in the form of an ad hominem argument. With regard to those who are opposed to direct lending, surely, the credibility of the Nation's finance industry in judging the ability of others to carry out lending functions has been somewhat compromised. We have had the great S and L scandals which the taxpayers will spend hundreds of billions cleaning up; in Boston, the major banks have written off billions of bad debts, and one major bank was lost in a merger; the GAO reviews of student loan guarantee agencies have found many to be in parlous position—not, I am happy to say, our Massachusetts agency.

So I would like to reiterate that we feel that we can carry out these lending functions responsibly.

Further, our belief is that direct lending will impose no heavy additional costs on Stonehill. My financial aid office has carefully reviewed our costs in handling the present loan program—and there are such costs—with our understanding of a direct loan program. As nearly as we can determine, these costs are about equal. The deputy secretary said in one of her comments that she saw the costs as about equal. We would agree; we consider the costs to be a wash.

As I noted, Federal aid student programs account for some 16 percent of our annual budget, and I have to consider any change or threat to that income seriously. But the present system is as open to instability as any alternative. Direct lending depends upon the presence of adequate loan capital for eligible students. The present system depends upon the willingness of Congress to grant subsidies to lenders and guarantees against default. The annual savings which direct lending is calculated to yield should, it seems to me, improve the outlook for student loan capital.

Having express our support for direct lending as we understand it, I think the committee should consider changes in two points of the President's proposal.

First, the bill waive's the Department of Education's statutory rulemaking process so that there may well be no public comment on the rules for direct lending before they go into operation. The Department, I understand, says the timing of the new program does not allow the normal process. We are anxious, however, about the Department's proposition that changes in rules will be easy in subsequent years. That is not our experiencing of Government regulatory agencies.

We would strongly, therefore, urge the committee to find a compromise between the full, formal processes of normal Federal regulation and the proposed absence of any consultative process.

Second, I believe that the committee should review some of the proposed income contingency payment provisions. I agree with almost all my colleagues in higher education in applauding the concept of income-contingent repayment, but the proposal appears to allow the Secretary the option of opening up such payment for 40 years.

Such a long repayment period, conjuring the possibility of alumni eligible for Social Security who are still paying college loans, seems to me to be unnecessary and seems to threaten—and this is the important thing—in some way the rationality of the proposal. We should not allow income-contingent repayment to become a form of indentured servitude.

The Federal Family Education Loan Program is a mainstay of our national commitment to college opportunity. To continue the program in its present form puts its stability and basic purpose at risk. And I agree that direct lending is not a silver bullet for the problems of financing college education, but, administered sensibly, it can make a real contribution toward the streamlining of a system already overwhelmed by its own complexity, and it will assure that the maximum share of Federal resources available for student aid goes to the students themselves.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

I did not, through my own oversight, introduce Lloyd Hackley, who is the chancellor of Fayetteville State University in Fayetteville, NC. Fayetteville State is a historically black college and offers a liberal arts program and has an enrollment of about 6,500.

Dr. Hackley, would you proceed?

Mr. HACKLEY. Thank you, Mr. Chairman.

Mr. Chairman, members of this distinguished committee, I am Lloyd Hackley, the chancellor at Fayetteville State University in Fayetteville, NC, and I am pleased to have this opportunity to testify on behalf of the Office for the Advancement of Public Black Colleges in the National Association of State Universities and Land-Grant Colleges, and the American Association of State Colleges and Universities. These two associations represent over 5.6 million students and constitute the largest volume of student loans and other forms of student financial assistance in the Nation.

America's State-assisted institutions of higher education are bound by a democratic philosophy that is envied and respected worldwide—a philosophy that boldly asserts that men and women of talent and ability, regardless of their economic and social condition, can achieve the American dream with hard work and a helping hand from higher education and the Nation.

In this whole debate, Mr. Chairman, the unique needs and circumstances of black colleges must be thoroughly examined, given our commitment to serving growing numbers of dependent and impoverished students who find equality of opportunity profoundly difficult to obtain.

With substantially limited resources, few political options, and marginal State support, black colleges continue to face competing fiscal priorities for maintaining the integrity of Federal financial aid programs. More than 50 percent of the 4,000 campus-based students at Fayetteville State University comes from families with incomes of less than $20,000 annually, and the majority of them receive some form of financial assistance.

From where I sit at this small, underfunded university in Fayetteville, I strongly believe that direct lending is in the best interest of the most important consumers—the 14 million students in the Nation's colleges and universities, especially those like the ones who predominate at Fayetteville State University.

From the public college perspective, the direct lending program has many key advantages. One, it will make loan capital available to students. It will assure availability of loans to all students during the transition period to full direct lending. It will better serve students and parents by making the process of getting and repaying loans easier to understand and easier to package for the students. It will generate considerable savings which can be used to provide additional funding in the future for other Federal student aid programs and reduce the national deficit.

It will provide institutions of higher education with the option of originating loans. No institution will be required to originate loans. Institutions will receive an administrative fee established by the Secretary of Education.

It will provide borrowers with various repayment options including income-contingent payment, and borrowers are allowed to change their choice of payment options.

However, there is a major concern that must be addressed in the legislative process in all Title IV programs. In the Act, institutions with default rates of 25 percent or more in at least one of the two most recent years for which default rates have been calculated will not be allowed to originate loans. As you know, historically black colleges and universities enroll a disproportionate share of low-income students who bring to our campuses all the inequities of our larger society. Thus, from 1988 to 1990, data will show that of 40 public black colleges, 10 have an average default rate greater than 25 percent, and 22 reported increases in the 1990 year compared to 1988. This alarming trend compels the Congress to extend the current law exemption for black colleges through 1997, or permanently exempt institutions that serve disproportionate numbers of low-income students and have low-volume defaults in terms of aggregate dollars.

It is time to reverse the skepticism about direct lending and turn it into a national priority—a commitment, a mandate, indeed, that propels our institutions into the 21st century, providing the full range of financial assistance to our students, who are making a deep and sustained difference in advancing equality of opportunity for all.

For these reasons and many others, it is the right time and the right thing to do, for all of the right reasons, and these reasons are: students, students, and students.

I sincerely appreciate this opportunity to testify, Mr. Chairman, before this body, on behalf of 35 historically black public colleges and the nearly 600 State and land-grant universities in the Nation.

[The prepared statement of Mr. Hackley follows:]

PREPARED STATEMENT OF LLOYD HACKLEY

Mr. Chairman, members of this distinguished committee, I am Lloyd Hackley, Chancellor, Fayetteville State University. I am pleased to have the opportunity to testify on behalf of the Office for the Advancement of Public Black Colleges (OAPBC), the National Association of State Universities and Land-Grant Colleges (NASULGC) and the American Association of State Colleges and Universities (AASCU). These two associations represent over 5.6 million students and constitute the largest volume of student loans and other forms of student financial assistance in the Nation.

America's State-assisted institutions of higher education are bound by a democratic philosophy that is envied and respected worldwide——a philosophy that boldly asserts that men and women of talent and ability, regardless of their economic and social condition, can achieve the "American Dream" with hard work and a helping hand from higher education and the Nation.

These institutions serve an enormous range of students in terms of economic, social and ethnic background. They are students from wealthy and welfare families. They come from rural communities in Lorman, MS, ravished neighborhoods in East St. Louis and the urban populous of Los Angeles, CA. They are from blue-collar, white-collar, and no-collar families—but they all come to the "people's universities" believing in the power of education to make a difference in their social and economic condition.

Today, American higher education is challenged as never before to bring academic and nonacademic functions closer together while improving our nation's ability to become more responsive to the educational, social and economic imperatives of a highly diverse student body. At a time when the nation is coming face-to-face with the dire consequences of massive human casualties in a $6 trillion economy, our institutions are looking for new ways to be more productive, more competitive, more fiscally-conscious and at the same time more responsive to human needs for the common good of the State and the Nation. Sharing a sense of responsibility for revitalizing our national economy, we in higher education are doing a better job of clarifying our missions and redefining our priorities while contributing to the larger national goal of restraining rising costs.

The higher education community is committed to providing insight, vision and leadership in moving forward to implement the Student Loan Reform Act. We can speak with pride about the willingness and the capacity of our institutions to use this extraordinary opportunity—to better serve our students. As Chancellor of Fayetteville State University, I commend the Committee for engaging the higher education community in helping to shape the Student Loan Reform Act. As instruments of the State and the Nation, public colleges and universities should be front and center in reforming Federal student aid programs, thus, insuring that direct lending is designed to serve the interest of our students and at the same time the national interest of our economy.

Mr. Chairman, we believe the President's proposal satisfies the essential criteria for a simplified, efficient direct loan program with tremendous savings for students, institutions of higher education and the nation. We have long advocated a system of student loans that is user-friendly, easily accessible, and fiscally responsible. As stated in a recent article by Thomas Butts and Elizabeth Hicks, "Direct lending offers the best of both centralization and decentralization . . . it eliminates the current system's confusing negotiations between the borrower and the university . . . funds go directly to students' billing accounts without compromising standards of integrity and accountability." This committee is on the threshold of an enormous opportunity to reform student aid—a reform that is long overdue.

The Department of Education is capable of administering direct lending. Educational institutions possess the efficiency, technical expertise, staffing, administration, physical plant, instrumentation and fiscal management capacity to meet this challenge. Our institutions have managed Work-study, Perkins and its predecessor, the National Defense Student Loan (NDSL), Supplemental Grants, and campus-based financial aid programs. The General Accounting Office found that the current system is "unauditable and not conducive to good financial management . . . and that a direct loan program would be easier to manage and greatly reduce the opportunities for error and abuse." The radical simplification that would ensue under direct lending would allow for better oversight and accountability and turn the current polygon—that includes the Department of Education, the school, the student, the lender, the guarantee agency, the secondary market, the servicer, the collector, and the Internal Revenue Service—into a triangular relationship that is more effective, sensible and integrated in the management and delivery of services—with the Department, the school, and the student in control.

From where I sit at a small, under-funded university in Fayetteville, North Carolina, I strongly believe that direct lending is in the best interest of the most important consumers—14 million students in the nation's colleges and universities.

From the public college perspective, the direct lending program has many key advantages:

- It will make loan capital available to all students.
- It will assure availability of loans to all students during the transition period to full direct lending.
- It will better serve students and parents by making the process of getting and repaying loans easier to understand.
- It will generate considerable savings which can be used to provide additional funding in the future for other Federal student aid programs and reduce the national deficit.

- It will provide institutions of higher education with the option of originating loans. No institution will be required to originate loans. Institutions will receive a small administrative fee established by the Secretary of Education.
- It will provide borrowers with various repayment options including income contingent repayment and borrowers are allowed to change their choice of repayment options.

There is no question about our support for this bill. Understandably, in legislation this complex, inevitably there are items that require perfecting. For example, the proposed 6.5 percent origination fee exacts too much from students and should be reduced below 5 percent or eliminated.

There have been those, even in the higher education community, who have expressed concern with parts of the legislation. Serving at a small historically black public university, we are willing and ready to take on this new opportunity. The higher education community must get busy preparing to meet the challenge, to smooth the way for our students and to take on some short-term adjustments and problems for long-term advancements and profit.

It is clear that sacrifices are required by all of us as we struggle with the overwhelming national debt. The higher education community is prepared to contribute to that effort. The $4.2 billion savings in the lending program contained in the budget resolution, if simply taken as a cut in student aid programs, would be devastating. Reducing the deficit is the wellspring of a more vibrant economy, a better standard of living, and ultimately, increased Federal resources for our students. The Student Loan Reform Act protects our students, while contributing to the national interest.

At the same time, we recognize that some of our smaller black colleges are concerned about any additional administrative responsibilities. The Act provides assistance for administrative costs and allows schools that do not wish to originate loans other alternatives. The higher education community will be prepared to address these and other concerns peculiar to small and limited-resource institutions in negotiated rulemaking with the Department of Education.

However, there is a major concern that must be addressed in the legislative process in all Title IV programs. In the Act, institutions with default rates of 25 percent or more in at least one of the two most recent years for which default rates have been calculated will not be allowed to originate loans. As you know, HBCU's enroll a disproportionate share of low-income students who bring to our campuses all the inequities of our larger society. Thus, 1988–1990 data show that of 40 public black colleges 10 have an average default rate greater than 25 percent and 22 reported increases in 1990 compared to 1988. This alarming trend compel the Congress to extend the current law exemption for black colleges through 1997 or permanently exempt institutions that serve disproportionate numbers of low-income students and have low-volume defaults in terms of aggregate dollars.

The unique needs and circumstances of black colleges must be thoroughly examined given our commitment to serve growing numbers of dependent and impoverished students who find equality of opportunity profoundly difficult to obtain. With substantially limited resources, few political options and marginal state support, black colleges continue to face competing fiscal priorities while maintaining the integrity of federal financial aid programs. More than 50 percent of the 4,000 students on my campus come from families with incomes of less than $20,000 annually and over 50 percent receive some form of financial assistance. Our loan volume in 1992–93 was over $1.4 million. In 1988 we had a default rate of 13 percent and in 1990 the rate increased to 14 percent. At a number of black colleges more than 75 percent of the entire student body receives financial assistance.

Given the realities of the economy compounded by the realities of inequality:

- We can't ignore the fact that between 1972 and 1990, median family income rose 8 percent compared with 89 percent between 1950 and 1970.
- We can't ignore the fact that the richest fifth of American families control about 43.7 percent of all income while 33 million people, with a disproportionate number being black Americans, remain locked in the wicked cycle of poverty.
- We can't ignore the fact that far too many low-income students are forced to make loans in the absence of State and Federal grants.

The condition of black America is a major indictment of our nation's unwillingness to come to grips with the pervasive economic problems that are crippling the ability of our children to have valid reasons to hope and to prosper. If the nation's black colleges are to pave the way for future generations, we must use this opportunity to redefine and restructure federal student financial aid programs for ALL colleges and universities and particularly those confronted with a host of social and economic barriers. Given the role of IRS and the simplicity of the program, direct lending may be the first step toward reducing defaults at black colleges.

As noted in Let's Take Back Student Aid: Direct Lending Issues and Myths, authored by G. Kay Jacks and Jerry Sullivan, financial aid directors at Colorado State University and the University of Colorado respectively, "We must remember why we have student loans . . . educational credit is first and foremost to make higher education a reality for those who cannot afford it. It is a social program, intended to promote society's goals through education. Any discussion about a change in Federal policy must be measured using students as the touchstone. Direct lending has been referred to " . . . as a Pell Grant with a promissory note. Others have called it a Perkins without a funding cap with no responsibility to service and collect loans . . . It allows institutions to focus on the individual students, not the unpredictable characteristics of an unexplainable loan program." By the way, copies of Let's Take Back Student Aid . . . were sent to every U.S. Senator.

I say it is time to reverse the skepticism about direct lending and turn it into a national priority, a commitment, a mandate that propels out institutions into the 21st Century, providing the full range of financial assistance to our students while making a deep and sustained difference in advancing equality of opportunity for all.

Direct lending——

(1) Streamlines and simplifies the loan process.

(2) Lowers the net cost to students and to the Federal Government.

(3) May reduce default rates and provides better repayment terms with income-contingent arrangements.

(4) Eliminates the existing profit-driven incentive structure and places student loan programs where they should be—in the hands and hearts of the higher education community.

For these reasons—it is the right time and the right thing to do for all the right reasons—and these reasons are students, students, students.

I sincerely appreciate this opportunity to testify before this august body on behalf of 35 historically black public colleges and universities and nearly 600 State and land-grant universities in the Nation.

The CHAIRMAN. Thank you very much.

Now, we'll hear from the students briefly.

Aisha Satterwhite, we welcome you.

Ms. SATTERWHITE. Thank you.

I am a junior at Clark University in Worcester, MA. Thank you, Chairman Kennedy and the committee, for this opportunity to speak today.

I am a political science major, and I am an active student leader on campus. After just 2 years of schooling, my estimated indebtedness is $10,000. I have taken out four loans within the last 2 years of my college experience—two Perkins loans and two Stafford loans. The Perkins loans are directly from Clark University, and the Stafford loans are from Shawmut Bank in Boston.

I have had no problems with my Perkins loans. Because these loans are through direct lending, the process is much simpler. My loan checks always come in on time, and all I have to do is initial them. There is never any hassle, and I never worry about the disbursement checks being delayed.

However, I have had my share of aggravations with the lender for my Stafford loans. I can recall nothing but problems when talking about the Stafford loan process.

My first Stafford loan was approved the summer prior to my enrollment at Clark, but upon arrival, I was told by Shawmut Bank that I was ineligible. You can imagine my dismay—$2,625 was on the line along with the prospect of my entering college. After I spoke with my student account representative at Clark, she made a few phone calls for me, and the matter with the Bank was seemingly settled. When my loan check finally came in, I discovered they had processed my application for the wrong loan amount—$1,000 less than what I had requested. After a lot of time, phone calls and stress, the issue was resolved.

But another issue I want to bring up is that of the origination fee. I only wanted to take out $2,271, and they charged me almost $400 just to get the money. So I have to pay $400 on every loan that I take out with the Stafford, and I have to pay back the actual loan amount, the origination fee, and the interest rate percentage, which is currently 8 percent for the bank that I am with, which is extremely high. I recommend that origination fees be eliminated using the savings from direct lending.

Although that matter was taken care of, my disbursement checks always came in late. This can affect my registration process if the checks come late at the wrong time of the school year. My registration was in fact held over once because of the absence of my loan check.

My Perkins loan checks are never late, and if there is ever a problem, then I work it out directly with my student accounts representative quickly and without complication.

I also recommended that the practice of delayed disbursement be stopped. I understand the bank's cautious attitude toward first-year students and whether or not they stay in college, but the absence of a loan check within the first 30 days of the semester can determine whether or not that student stays in school. The absence of any amount of money a student is relying on can send that student home instead of to class.

My second Stafford was approved the summer prior to my second year at Clark, but once again, the application process was delayed due to misplaced paperwork. Shawmut Bank refused to send the necessary information to my campus box; they repeatedly sent it to my residence in DC., which caused a lot of problems for me. Finally, after a lot of persuasion and many phone calls made by my student accounts representative, the bank send the papers to me at school.

To top off my past experiences, I recently found out that my loans have been turned over to another agency, Education Loan Services, Inc.

The process has been made even more confusing because Shawmut Bank still owns my loans technically, but ELSI is responsible for making adjustments to my account, processing payments, and answering any questions I might have. They gave me a letter and an 800 number, but it is almost impossible for me to get prompt service and prompt response from them when I have a problem with my loans.

My experience with the Stafford loan procedure has obviously not been a pleasant one. I think it would make more sense, and it would be more convenient for both the financial aid office at Clark and other institutions and for students as well to obtain student loans through direct lending. Problems could be handled swiftly and efficiently directly on campus, and it would definitely be less time-consuming.

I have also spoken with Peter Guimette, the director of financial aid at Clark, and he strongly agrees. Guimette feels that it makes more sense to service students directly. It is easier, and it could be handled the same way the Perkins loans are handled.

I have been working with the United States Student Association, and I agree with USA in that students could benefit from lower interest rates and more simplified process.

I urge Members of Congress to support the direct lending program because there are many benefits involved for those who are borrowing large amounts of money for their schooling.

I would like to thank you again for providing me the opportunity to speak.

Senator Simon [presiding]. And we thank you for coming here.

J.L. Nelson, a student at Iowa State University. Welcome.

Mr. NELSON. I want to thank Chairman Kennedy and the committee for giving me the opportunity to speak today. I also want to thank the United States Student Association for all the work that they do for students in this country.

My name is Jerome L. Nelson, Jr. I am a junior majoring in history at Iowa State at Ames. I am one of a growing number of nontraditional students at Iowa State. I am 32 years old and have been married for 11 years. I have three children, ages 8, 4, and 23 months.

After working for 11 years, I decided to return to school. The decision was a difficult one to make. I hadn't been a very good student in high school, and my wife had just had our second son. The only jobs available in our area for someone with only a high school education paid minimum wage; this made the decision to return to school much easier.

I applied and was accepted at Iowa State, and I entered in the fall of 1989. College opened a whole new world for me. I had never received any grade higher than a "C" in high school, but after my first semester at ISU, I had a GPA of 3.89. Since then, my classes have gotten tougher, but I have maintained a B-plus average.

My second year in school, I got involved in student government and was voted senator of the year twice for my involvement. This spring I was named to the Cardinal Key Society, the most prestigious honorary at Iowa State.

Each year, I receive the maximum Pell grant as part of my financial aid package. The grant is the only part of my financial aid package that I can count to be there on time, and I wish Senator Pell were still here, because I wanted to thank him for the Pell grants.

This Pell grant is not nearly enough money to cover my expenses for a semester, so I have to borrow money if I want to stay in school. At this time, I owe over $23,000 in student loans—$13,875 in Stafford loans and $10,000 in Supplemental Loans for Students. I have recently applied for and expect to receive an additional Stafford loan of $3,000. This will bring the total I owe at the end of my junior year to $26,875.

The current student loan system has been a very difficult road for me. I have been forced to deal with one obstacle after another. One of these obstacles is the origination fees. Although I have borrowed over $23,000, more than $1,300 has been taken from me in origination fees. This would have been enough money for me to purchase roughly six semester of textbooks.

I hope that when the direct lending program becomes a reality, origination fees can be eliminated through the savings generated from the program. I wish each and every one of you Senators could stand in line at the ISU treasurer's office when the bulk of student loans are disbursed. You would then be able to hear the shock and outrage when a student is told they must pay back 100 percent of a loan when they have actually received much less.

Not only have I had to pay high origination fees—I have also had to battle loan servicers who have mishandled my loans. For example, during the spring semester of 1991, a portion of my SLS loans went into repayment since I enrolled as only a quarter-time student in order to earn some money so I could stay in school. I have had to hassle with these SLS loans ever since.

At one time, the note was held by the Iowa State University Credit Union. It was then sold to the Iowa Student Loan Liquidity Corporation, and now it is owned by a company called Unipac. Every semester, Unipac assigns my loan to a collection agency until they receive the deferment papers I am forced to send.

The CHAIRMAN. Are they in Iowa?

Mr. NELSON. No; they are in Denver, CO.

Often, I have to send two or three deferment forms for them to receive one form. We have taken to faxing them, so they get them that way.

While the deferments are being processed, I have been called repeatedly by a collection agency, which demanded payment immediately. They assign my loan to a collection agency even though they hold onto it. The fact that this loan needs to be deferred every semester, and often shows up as delinquent, causes my other loans to be delayed.

It is hard to describe the hardships these delays have caused. I have had to go for up to a month into a semester without buying books for my classes. I am often charged for late payment of my tuition and fees. Bills go unpaid, and macaroni and cheese are regular fare at the dinner table. Borrowing money from friends so my family can eat is not uncommon. Then, when the loan does come in, it is gone.

A very frustrating situation is when the bank sends a letter telling me a loan has been approved and will be disbursed on a certain day; the loan is then held up because the guarantee agency shows me to be delinquent. I anticipate the loan I have taken for this summer semester will be delayed until I can once again prove I was enrolled full-time this last semester and am enrolled full-time for the summer.

By the time I finish my bachelor's degree, my debt will have passed the $30,000 mark. I want to go to law school and pursue a career in the field of child advocacy. As you know, this is not a big money field. I would be a willing participant in the income-contingent loan repayment plan, but the thought of the interest that could add up is staggering. Will I be using my Social Security checks to pay off my student loans after I retire?

One alternative would be to limit the total amount one person could repay to 200 percent of their original loan amount. Also, anyone who has been in repayment for 20 years should have the rest of their loan forgiven. Also, some form of interest forgiveness for loans that are kept current should be considered. I don't believe the Federal student loan programs were set up to line the pockets of the banks, savings and loans and credit unions of this country. They were set up to assist students in paying for college.

Thank you again for the opportunity to testify, and I urge you to support direct lending.

The CHAIRMAN. Thank you very much.

Mr. Kraig.

Mr. KRAIG. It is a great honor to be called before this committee. My name is Robert Kraig. I hold a staff position with the State Student Association in Wisconsin, United Council, and I am also working on a doctorate at the University of Wisconsin-Madison.

Today, I will discuss my own experience with the present guaranteed student loan program, both as a student and as a student leader.

As a student over $20,000 in debt, I have a great deal of first-hand experience with the present student loan program. I have found the present system to be extremely complicated and very slow to respond to my needs as a student. I have sometimes had to go more than a month into the semester before receiving my loan disbursements. Some semesters, I have been forced to run up huge credit card debts and to delay paying other bills.

I have also had great difficulty navigating the highly-involved repayment phase of the student loan process. I have often had difficulty receiving the deferments for which I am eligible. I have been asked repeatedly to make student loan payments during the summers, despite the fact that I have been a continuing student and am not paid as a teaching assistant during the summer.

Additionally, I have had absolutely no luck in securing income-contingent repayment, or "income-sensitive," as it is called now, even though I currently hold a low-paying community service position.

Probably the greatest problem I have encountered is that my loans are from two different guarantee agencies, neither of which will take the other into account when calculating my monthly payments. In my view, the simplicity and the repayment flexibility of the bill under consideration today would be of great benefit to student borrowers. Under direct lending, all of my loans would be with the Federal Government, so combining them into a single income-contingent payment would not be much of a problem.

I have also observed some of the inherent flaws in the status quo from my point of vantage as a student leader. There has been a raging controversy in Wisconsin surrounding the collection practices of the major student loan servicing agency in the State. The agency has been widely accused of failing to offer legally-required repayment options. There have also been numerous accusations by student borrowers of repeated harassment by the agency's representatives, including outright intimidation and phone calls in the middle of the night.

I personally received a 6 a.m. call from the agency for the purpose of verifying my name and address. Although I found this annoying, I am aware of far more abusive practices, and many of these practices have been reported in State assembly and State senate hearings that have occurred over the last couple of years. While I certainly do not condone nonpayment of loans, I believe this kind of harassment is entirely unnecessary.

S. 920 would remedy this situation by giving the Secretary of Education more direct oversight over the contractors who would collect loan payments.

My personal experience with the controversy over guaranteed student loans also extends into the realm of political lobbying—and you can certainly read about that in the morning papers today. But the focus of today's hearing is on the merits of the issue, and I would prefer that the focus stay that way.

I wish to thank Senator Kennedy and the entire committee for giving me the opportunity to testify today. It has been an honor and a privilege to be of service in these notable proceedings.

Thank you.

[The prepared statement of Mr. Kraig follows:]

PREPARED STATEMENT OF ROBERT KRAIG

It is a great honor to be called before thin committee. My name is Robert Kraig. I am the Shared Governance Director at the United Council of UW Student Governments—the state student association in Wisconsin. I am also working on a doctorate in the Department of Communications Arts, University of Wisconsin-Madison. Today I will discuss my own experience with the present guaranteed student loan program both as a student and a student leader.

As a student over $20,000 in debt, I have a great deal of first hand experience with the present student loan program. I believe my experience to be more or less representative of the difficulties many students are facing. I have found the present system to be extremely complicated an very slow to respond to my needs as a student. It is difficult to apply for loans, in part because the loan system is separate from the rest of the financial aid system. As a graduate student, I have sometimes had to go more than a month into the semester before receiving my loan disbursements. Some semesters, I have been forced to run up huge credit card debts and to delay paying other bills.

I have also had great difficulties navigating the highly involved repayment phase of the student loan process. I have often had difficulty receiving the deferments which by law I am eligible. I have been asked repeatedly to make student loan payments during summers, despite the fact that I have been a continuing student and am not paid as a teaching-assistant during the summer. Additionally, I have had absolutely no luck in securing income-contingent repayment, even though I currently hold a low-paying community service position. Last week, one of my loan servicing agencies told me I either ha to make $215 payments, nearly half my take-home salary, or go into forbearance, and pay nothing while interest builds up. In other words, they would give me no option between zero and $215. I have also had difficulty getting clear and accurate information from my loan servicing agencies. Last week, one of my loan servicing agencies told me that they had never heard of income-sensitive repayment.

Probably the greatest problem I have encountered is that my loans are from two different guarantee agencies undergraduate loans and the other for graduate school—neither of which will take the other into account when calculating my monthly payments. As a result of this lack of cooperation between my loan agencies, I have been asked to make unreasonable monthly payments. In my view, the simplicity and the repayment flexibility of S. 920 would alleviate many of the predicaments confronting student borrowers. Under direct lending, all of my loans would be with the Federal Government, so combining them into a single, income-contingent, payment would not be a problem.

I have also observed some of the inherent flaws in the status quo from my point of vantage as a student-leader. It may not be very well-known inside the beltway, but there has been a raging controversy in Wisconsin surrounding the collection practices of the major student loan servicing agency in the State, the Great Lakes Higher Education Corporation (GLHEC There have been numerous complaints to the Wisconsin Consumer Protection Agency, the Wisconsin Banking Commission, and State lawmakers concerning GLHEC's collection tactics. GLHEC has been widely accused of failing to offer legally required repayment options and refusing to provide adequate information or borrower repayment records. There have also been numerous accusations by student borrowers of repeated harassment by GLHEC representatives, including outright intimidation and phone calls in the middle of the night. I personally received a 6:00 a.m. call from GLHEC, for the purpose of verifying my name and address. Although I found this annoying, I am aware of far more abusive practices. Students have testified in hearings before the State Legislature that GLHEC representatives called student epithets such as "dead beat" and "cheat", and demanded that they get loans from their parents, or get higher paying jobs so that they could make their loan payments in full. While I certainly do not condone nonpayment of loans, I believe that this kind of harassment is entirely unnecessary. As I have stated, GLHEC is not covered by Wisconsin collection laws. In reaction to a torrent of constituent complaints, the Wisconsin State Legislature has twice passed legislation to regulate the collection activities of GLHEC—AB 172 in 1990 and AB 712 in 1992 both sponsored by State Representative Stan Gruszynski. Unfortunately, Governor Tommy Thompson has vetoed both bills on the grounds that they would conflict with Federal prerogatives, leaving GLHEC's collection practices unregulated. I think the difficulty Wisconsin students have had with their student loan servicing agency is related to the bewildering complexity of the Federal student loan program. In a system that depends on 7,800 lenders and 46 guarantee agencies, it is next to impossible to insure fair and uniform collection practices for all GSL recipients. As it stands now, the service students receive is based entirely on the vagaries of fortune—the luck of the draw. S. 920 would remedy this situation by giving the Secretary of Education more direct oversight over the contractors that would collect that loan payments.

My personal experience with the controversy over Guaranteed Student Loans also extends into the realm of political lobbying. But the focus of today's hearing is on the merits of the issue, and I would prefer that the focus stay that way.

I wish to thank Senator Kennedy, and the entire Committee on Labor and Human Resources, for giving me the opportunity to testify today. It has been an honor and a privilege to be of service in these notable proceedings.

The CHAIRMAN. Thank you very much. We'll try to move the questions along.

Let me ask the students this question about the lowering of the interest rate versus origination fee. How do you balance that, in your own thoughts? The House moved to lower the percentage even further than the administration wants, and I think there is a general desire to do it by a number of the members of the committee—we haven't really gotten into it, but I know that has certainly been a subject with a lot of the students. All of you have referred to it, and I am interested in where you come out in terms of lower interest rates versus origination fee.

Ms. SATTERWHITE. Well, personally, I feel that I am being penalized for wanting to borrow money to continue my education and be a contributing member of society. The rate I have now is 8 percent, which is extremely high. I heard it was supposed to be 6 percent, but that's what I got from the bank that offered me the loan at school.

I think it is unfair for them to put these pressures on students, especially since when we get out, we are struggling to find jobs, and we have to pay them back, plus the interest, plus the amount of money that you say you have to give them back because they were gracious enough to give you money to go to school.

I think the other two gentlemen can probably handle the question better since I have only been in school for 2 years, and they have much more debt than I do so they understand the process a little more fully than I do.

The CHAIRMAN. Mr. Nelson.

Mr. NELSON. I'd like to say that's a really tough call because in the long run, I'll be paying less money with the lower interest rate. But I've got to tell you, at the beginning of the semester, whenever my checks come in, I could really use that money, because it is still tight, even maxing out the loans. You know, that extra $200 to

$400 goes a long way. So it is a tough call. In the long run, I'd be better off if the interest rates were lower.

As far as the origination fees, right now, I want that money. That money would help to purchase a lot of things for me right now. But in the long run, I'd be better off with lower interest rates.

The CHAIRMAN. Mr. Kraig.

Mr. KRAIG. This is being talked about mostly as a trade-off. I know the U.S. Student Association, which represents millions of students, recommends getting rid of the origination fees and keeping interest rates where they are. The advantage of that would be that students with smaller loans, like one of the witnesses today, are really hit harder by the origination fees than those with larger loans.

The disadvantage of that, though, is that if people with larger loans are more needy, then perhaps it is regressive to give everyone the origination fees off and then have people with huge loans paying higher interest rates. So I agree it is a tough call, but I will say that the U.S. Student Association goes with the origination fees.

The CHAIRMAN. I think that is helpful as we wrestle with this. Currently, the administration's direct loan is at 6.5; in the House bill, it is 5 percent from 1994 to 1997, and then 3.6 percent from 1997 to the out-years. So I think there is a real desire here across the board to get at that.

I think it is just absolutely extraordinary when you talked about close to $400 in origination fees for a $2,600 loan.

Ms. SATTERWHITE. That's right.

Senator JEFFORDS. Most of that goes to Uncle Sam.

The CHAIRMAN. Just a very brief comment on flexibility in terms of the interest repayment. We have an income-contingency program, and in that program is some ability for flexibility, so if you are doing really well financially, you can pay it off more quickly. I would ask the students, do you find that appealing?

Let the record show that Aisha is nodding approvingly.

Ms. SATTERWHITE. Well, the kind of job I want to go into when I graduate and get my professional degrees—what I am interested in is not going to pay me a large amount of money right off the bat; it is going to take years and years of time and commitment to get the amount of money that I would like to earn as a life goal.

When I get out of school, I know I am not going to make very much money if I find an adequate job. It would be extremely helpful if I could deal with someone in charge of my student loans who was responsive to my needs as a loan person, and saying thank you, basically, for letting me get through school, and I am going to pay you back because I promised you I would. I think it would only be fair for them to recognize that there are constraints on students when they get out of school—economic, social, what-have-you—and it would service us better. Since we are going into debt to do this, it would service us better if they were a little more allowing in how we pay them back, because we are going to pay them back. It would just make more sense if they were a little more understanding about how much we can pay back, and when, and what circumstances in our lives were bearing on how we could pay them back.

The CHAIRMAN. My time has expired.

Aisha, I understand your mother and sister are here. Could they stand up?

Ms. SATTERWHITE. Yes.

The CHAIRMAN. We are delighted to have you. We thank you very much.

Senator Kassebaum.

Senator KASSEBAUM. Just a couple of things, Mr. Chairman. There have been frequent comments about the simplicity and the savings that will be inherent in the system. I think it is important that everybody recognize that even under direct lending, students are going to have to fill out the basic Federal form that determines needs analysis, and at the time of the higher education reauthorization, we spent a lot of time trying to simplify that form. It was incredibly complicated.

I would concur with everyone who would like to see it further improved, but it is still there under direct lending, and there would also be the promissory note to be filled out. So much of that remains the same.

All students today are assured access to student loans. That remains the same. And I think the concerns of those of us who would like to see it be put under a pilot program for a time really are not arguing against direct lending so much as just wanting people to be realistic about what the options are and what the savings may be.

There has been a lot of talk about origination fees and reduced interest rates, where I would ask—is it going to be a savings to the Government or do we find a way to make it a savings to the student. Under the administration's proposal, the interest rate the Government will charge on any direct loan it makes after 1997 will be reduced by half a percent. However, this will only amount to a monthly savings of approximately $1.33, or about $13 per year. Now, that is not a significant saving. So I guess I want to put it in perspective. There are many things that we hope could be accomplished, but I am not sure even a more personal relationship is going to be possible, because we talked about earlier through some questioning of Secretary Kunin exactly how it would be handled and how one would track one's loan.

So I think these are major questions that do need to be asked, and I am very appreciative of the testimony.

I would say, Mr. Nelson, as you know, the administration is recommending that probably after 25 years—although this has still not been determined for certain—loans would be forgiven under income-contingent repayment.

Mr. NELSON. Yes, I was aware of that. I see a lot of the positions that people who would be taking that income-continent option—I do know about President Clinton's national service program—these people are in service-oriented, community service jobs.

The other thing I wanted to mention is the form that we will out every year—I want to thank you—that is free now.

Senator KASSEBAUM. Yes, that's true, and that is better.

Mr. NELSON. I don't have to pay the money for that.

Senator KASSEBAUM. Well, there always was the free form, but part of the difficulty is that there are other forms that are required by the State that have to be filled out; but the free Federal form was always available. It was not an option; it was always available.

Mr. NELSON. I did not know that until you just said it, and that is something that I would think that my financial aid office should have told me, that there is a free form. It was always that you had to mail in the check.

Senator KASSEBAUM. Mr. Kraig, I don't want to wade into the allegations that have been made regarding the students at Wisconsin, but I want you to be aware if you are not—that Brian Williams, a student who attended the briefing with you at Sallie Mae, has asked that a statement of his be entered into the record. He states that Sallie Mae officials never suggested that you or he set up a student organization to fight direct lending. He just asked that that statement be made a part of the record.

[The prepared statement of Mr. Brian Williams follows:]

May 25, 1993

To: The Honorable Nancy Kassebaum
Lisa Ross

From: Brian J. Williams

Re: Hearing on Student Loan Reform Act

Testimony will be given on Wednesday, May 26 by Robert Kraig before the Senate Labor and Human Resources Committee which may make reference to a briefing he attended at Sallie Mae's expense. As I was in attendance at this briefing, I request permission to have the following statement of clarification entered on the record:

I feel compelled to respond to the uncontrolled and unproved accusations being made about my involvement and motivations with regard to a briefing I attended on Monday, May 17 at Sallie Mae's expense. I approached Sallie Mae to solicit their perspective on direct lending. Sallie Mae offered to send officials to Wisconsin to brief me on recent developments in the ongoing direct lending debate. However, I chose to come to Washington for this briefing on my own accord.

Perhaps most disturbing to me are the unfounded allegations made on Tuesday, May 25 by a student who attended this briefing with me that Sallie Mae offered to fund a dummy student organization to be set up in Madison, WI to engage in an anti-direct lending campaign with the structural and financial support of Sallie Mae. Such a ludicrous suggestion was never made nor even hinted at by the Sallie Mae representatives in attendance at this briefing. I am appalled that such baseless lies are being used by pro-direct lending forces solely for the purpose of scoring political points.*

I have absolutely no vested interest, financial or otherwise, in this debate other than to express my personal views. My only hope is that the advocates of direct lending will see fit to conduct their future activities with the integrity they claim to possess.

* See attached article from the 5/25/93 *Capital Times*.

DANE COUNTY'S AFTERNOON NEWSPAPER

The Capital Times

Volume [illegible]

MADISON, WISCONSIN ★ ★ ★ TUESDAY, MAY 25, 1993

UW student blows whistle on lobby scam

By [illegible]

The Capital Times

A University of Wisconsin-Madison student is drawing national attention by exposing the lobbying efforts of one of the country's largest student loan collection agencies.

Robert Kraig, a graduate student, said today that the Student Loan Marketing Association, or Sallie Mae, flew him to Washington, D.C., last week and tried to enlist him as a lobbyist.

Their target: President Clinton's Student Loan Reform Act.

Should Clinton's plan gain congressional approval, Sallie Mae and a host of savings and loans stand to lose a good portion of a multibillion-dollar business.

• • •

Agency fighting Clinton reform

Sallie Mae selected Kraig because he is on the staff of the United Council of University of Wisconsin Student Governments, a state body representing about 130,000 students.

In Washington for a press conference before he testifies Wednesday before the U.S. Senate, Kraig said today that two Sallie Mae representatives [illegible] how to advertise and set up a student-run lobbying organization in Madison.

Afterward, Kraig said he immediately told the office of U.S. Sen. Paul Simon, D-Ill., whose Labor and Human Relations Committee is holding hearings on Clinton's package this week.

One of Simon's staff directors, Brian Kennedy, said Kraig's revelation was "astounding."

"It shows the lengths to which they are willing to stoop to trump up student opposition by creating sham student groups," Kennedy said. "It's the kind of special interest power grab we're trying to get away from.

"The special interests are making billions of dollars off the current system with the public taking the risk," Kennedy said.

Representatives from the association could not be reached for comment today.

Kraig, reached by phone in Washington, said Sallie Mae's ploy surprised him.

"It's an attempt to disguise a portion of their advertising and lobbying campaign as independent student opinion," he said. "Sallie Mae has treated student opinion as something that can be manipulated for their own ends."

Banks now make student loans under which the interest is paid by the federal government until the student gets out of college.

Continued on Back Page

Loans

■ Continued from Page 1A

Banks then sell the loans at a profit to groups like the Great Lakes Higher Education Corp. that collect monthly payments from students.

In Wisconsin, Great Lakes has been accused of making calls at all hours of the night and harassing debtors.

Kraig, whose current student loan debt stands at $20,000, got involved in the scheme by accident, he said.

He met with Sallie Mae representatives May 17 as a last-minute replacement for another student.

Flown to Washington by the association, he said two representatives tried to sell him and another student on an "all-out assault on the direct lending plan." They wanted them to set up a program in Madison that looked like one already operating in Ohio.

It would have the look and feel of a student grassroots group, but the association would pay its operating costs, Kraig said.

Particularly upsetting to Kraig, who is studying for a doctorate in communications, is that Sallie Mae was established by the federal government.

"Such a policy is particularly galling when it comes from a publicly created entity," he said.

Mr. **KRAIG**. OK. I didn't know that. Obviously, all I can report to you is what happened at the meeting. And I have not only reported thoroughly what happened at the meeting, but I have also brought the materials, and they have been widely distributed. So I just have to stand by what I saw.

Senator **KASSEBAUM**. There were evidently different interpretations of that meeting.

Thank you very much.

Thank you, Mr. Chairman.

The **CHAIRMAN**. Senator Simon.

Senator **SIMON**. Thank you.

First, after listening to these three students, I understand why the United States Student Association is so strongly for direct lending, and we appreciate your testimony here.

Father MacPhaidin, I agree with you on a 25-year limitation. The bill that Senator Durenberger and I had in did have a 25-year limitation. Obviously, if you pay your loan back before that, it would be before that.

Dr. Hackley, I think one of the advantages of this is that we move away from this default system which really is tough on schools that serve the economically disadvantaged. I appreciate your being here and your testimony.

Finally, if I may follow through with Senator Kassebaum's statement, the morning newspaper says, "At yesterday's news conference, Robert Kraig, a Wisconsin graduate student, said that Sallie Mae flew him and a friend here May 17th and arranged a meeting at its Georgetown offices with the institution's top legislative officials. A Sallie Mae spokeswoman said the students were flown in' to hear our perspective on the issue,' and they were shown the Ohio materials. But she denied that they were asked to form a similar group or offered funds for such a group. ' We have never been and never will be engaged in activities of that nature.'"

Now, first of all, why do you think they flew you out from Wisconsin?

Mr. **KRAIG**. Well, in other words, for what other possible purpose?

Senator **SIMON**. Yes. Do you think they liked the color of your eyes, or do you think they had something else in mind?

Mr. **KRAIG**. I can't imagine that it wouldn't be to have us influence lawmakers. We were lobbying the second half of the day. And also, at the very top of the meeting, they showed us the Ohio ad copy materials and said they would take care of things if we were willing to set up a similar organization in Wisconsin. So that was at the top of the meeting.

Senator **SIMON**. So when they said they would "take care of things" if you set up a similar organization in Wisconsin, you clearly got the impression they wanted you to set up a similar organization, and when they said they would "take care of things," they didn't mean they were just going to fly you back home, did they?

Mr. **KRAIG**. No, and they showed us extremely professional ad copy, Madison Avenue quality, so I couldn't interpret it any other way than that.

Senator **SIMON**. All right. I thank you all very, very much for your testimony. I appreciate it.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Jeffords.

Senator JEFFORDS. Mr. Chairman, thank you, and I thank the witnesses for their excellent testimony.

I would just like to point out that you should not necessarily feel because we are going to change to direct lending that some of the problems you have faced will not be there. The thought of having the Internal Revenue Service bugging me versus some private agency does not thrill me as being a more satisfactory person to deal with—it may some, but not me. I have dealt with them too many times—not, of course, for myself, but for other clients. [Laughter.]

And also, regarding the origination fees, most of that money goes to Uncle Sam. What we did—we loaned you the money, but then we took part of it back so that your interest rate was actually higher than we told you, because you never got the money to start with. But that was done because we were ordered by the budget committees to save money, so we saved it out of your pocket. That probably doesn't make you very happy.

I do want to thank you for coming. I think you have also brought up something we have been discussing, and that is the need to have someone you can contact on your loans who isn't at the end of an 800 number, and I am hopeful we can correct that.

Mr. Hackley, I think you agree with that aspect, that it is going to be tough if we aren't very careful; and just by privatization or competitive bidding does not necessarily mean you are going to get nice sounding people at the other end of the phone. So we have to do something.

Mr. HACKLEY. Yes, I agree.

Senator JEFFORDS. Yes, Father MacPhaidin?

Rev. MACPHAIDIN. Senator Jeffords, our folders are filled with the arguments, pro and con, direct lending versus status quo, and some of the arguments have been blown up into nightmares. But I think it is wonderful to have this opportunity to conduct a rational discussion on the pros and cons, and as we have this wonderful opportunity to appear before you on behalf of the Nation's students, we realize the difficulties and all the cautions, and we wish the committee well in its deliberations.

There is just one thing that I would like to mention that I don't think has been touched on by anyone, and that is that we are being told that in the decades ahead, the population in America's universities and colleges is going to be a fairly different population. Already, even at a college the size of Stonehill, we have begun to adopt classes in grade school in the neighboring city of Brockton, and work with the banks in Boston to prepare students even from grade school so that they have the skills.

I have to tell you that many of them are from single-parent families, and the complexities of the present system, if it is above our present-day generation of students, those complexities will certainly be above the heads of many of the newer students in the decades ahead.

I am not saying that to downgrade the students who are coming, but I am just saying that the complexity will well night overwhelm them.

Senator JEFFORDS. I understand. I just want to say also that it is my great hope that the national service program will provide options for students, especially those like Aisha here today, to get out from under their loan burdens while at the same time providing a service to the country. So I have more hopes that, rather than the income-contingent loan option, when the national service program gets going, it will be a much more preferable option for students to reduce the demands on them.

Thank you, Mr. Chairman.

Mr. NELSON. If I could comment on that.

Senator JEFFORDS. Certainly.

Mr. NELSON. I mentioned that I am a nontraditional student, and I believe that that population is growing. One of the scary things for me about the national service program is that it isn't available for nontraditional students. It seems like they are going for the traditional 4 years, which is not going to be traditional anymore, either; but they are going for the younger generation.

Senator JEFFORDS. Well, hopefully we can take care of your problem. Thank you.

Senator SIMON. If I could just comment on that point, too—and I am all for the national service idea—but even when it reaches its fullest under the present plan, it is going to reach 150,000 students. It is not going to reach very many students. We have to think about the millions who aren't served by it as well.

Senator JEFFORDS. My only point is that it should be a couple million rather than 150,000, and that's the way I visualize it in the future.

Senator SIMON. You take care of the costs on that, and I'll vote with you. [Laughter.]

Senator JEFFORDS. Oh, we can do that. We've just got to reorder our priorities.

Senator Wellstone [presiding.] I would like to thank each of the panelists. Thank you very much for your testimony.

We will now move on to the third panel.

Senator SIMON. Mr. Chairman, before the next panel comes forward, I am supposed to give a talk on literacy to the Newspaper Publishers Association. I am vitally concerned about this, but I am also going to have to duck out very shortly, and I apologize to my friends who are here that I won't be here for the full hearing.

Senator WELLSTONE. I think everybody knows of your strong concern and interest and leadership, Senator Simon.

Our final panel today consists of people who have operated the guaranteed loan system and who have studied that system and have seen it work.

We welcome Mr. Marshall Witten of Bennington, VT, who is a partner in the law firm of Witten, Saltenstahl and Wolmington, and was commissioner of the National Commission on Responsibilities for Financing Postsecondary Education, a commission created by the Congress and cosponsored by Senator Jeffords. Mr. Witten is also chairman of the Vermont State College board of trustees.

Our next panelist is Ms. Claire Roemer of Fort Worth, TX, who is student financial aid district coordinator for the Tarrant County junior college district. Ms. Roemer is also chairwoman-elect of the National Association of Student Financial Aid Administrators, which is the largest association of student financial aid professionals.

We also have with us today Dr. Robert Atwell, president of the American Council on Education, which is the umbrella organization for higher education in the United States. Its membership includes more than 1,500 colleges and universities and over 200 educational associations.

We are also pleased to have Mr. Stephen Biklen of Rochester, NY with us today. Mr. Biklen is the president and chief executive officer of the Student Loan Corporation, a subsidiary of Citicorp Bank.

Next, allow me to introduce Mr. Dan Cheever of Boston, MA. Dr. Cheever is the president of the American Student Assistance Corporation and is also chairman of the Coalition for Student Loan Reform, a group of guarantee agencies and secondary markets.

And our final panelist is Mr. John Schullo of Bemidji, MN—notice the emphasis on Bemidji, MN. Mr. Schullo is director of financial aid at Bemidji State University in Minnesota, a public liberal arts school with an enrollment of about 5,400.

I believe Senator Jeffords and Senator Kassebaum might want to make some brief introductions, and then we'll proceed with the testimony.

Senator Jeffords.

Senator JEFFORDS. Thank you, Mr. Chairman. I also have a speech to make downtown on the exciting subject of pension reform, so I will unfortunately have to leave in a very few minutes, but I didn't want to leave without welcoming Marshall Witten here. He is a classmate of mine, and we have worked together on many things over the years. He has been an outstanding leader in our State on postsecondary education. But most importantly, I want to make everyone aware that on the commission to make higher education affordable again, he was one of the real leaders who held the commission together and helped it to come out with the forceful recommendations of which direct lending was one, which I support. So I just want to publicly thank him for the tremendous service he has rendered to those people interested in higher education to make sure that it does become affordable again.

Thank you, Mr. Chairman.

Senator WELLSTONE. With that strong recommendation from a fine Senator, Mr. Witten, we'll let you start off.

STATEMENTS OF R. MARSHALL WITTEN, COMMISSIONER, NATIONAL COMMISSION ON RESPONSIBILITIES FOR FINANCING POSTSECONDARY EDUCATION, BENNINGTON, VT; CLAIRE ROEMER, PRESIDENT-ELECT, NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS, FORT WORTH, TX; ROBERT H. ATWELL, PRESIDENT, AMERICAN COUNCIL ON EDUCATION, WASHINGTON, DC; DANIEL S. CHEEVER, JR., PRESIDENT, AMERICAN STUDENT ASSISTANCE, BOSTON, MA; STEPHEN C. BIKLEN, PRESIDENT AND CEO, THE STUDENT LOAN CORPORATION, ROCHESTER, NY, AND JOHN SCHULLO, DIRECTOR OF FINANCIAL AID, BEMIDJI STATE UNIVERSITY, BEMIDJI, MN

Mr. Witten. Mr. Chairman, Senator Jeffords, thank you, and distinguished members of the committee, thank you for this opportunity to testify on the Student Loan Reform Act of 1993.

For those of you who are not familiar with the commission, the commission was created as a part of the Higher Education Reauthorization Act of 1986 through language crafted by Senator Jeffords. It included nine members appointed by the President, the majority leader of the Senate, and the speaker of the House.

The commission was given the daunting responsibility of determining a comprehensive strategy for long-term higher education financing policy. In trying to achieve that objective, the commission met over a dozen times, hosted regional hearings and national symposia and seminars, and conducted extensive research on the problems of the current system as well as prospects for the future.

Among the many strengths of this commission has been both its professional diversity and its bipartisan nature. Our members represent a cross-section of the business and education communities, and they encompass the spectrum of political ideology. The collective "resume" of the commission includes experience that ranges from a former United States Senator to the president of an independent college to the chairman and CEO of a major multinational corporation.

We believe our final report, "Making College Affordable Again," the unanimous consensus of the commission, provides a framework for the development of postsecondary financing policy over the next several years. The report, delivered to you, to your congressional colleagues and the President in early February, is probably the first federally sponsored study in at least 20 years to offer an independent bipartisan assessment of the overall financing picture for postsecondary education.

Given the time constraints, I will not attempt to summarize the entire report. However, I do want to observe that many of the key themes of our report are embodied in the Student Loan Reform Act of 1993. In particular, our report strongly endorses the concept of simplicity in determining eligibility and awarding all forms of student aid.

We found complexity of the student aid program to be a major barrier to access to higher education in this country, and a direct lending system—eliminating thousands of lenders and radically reducing the number of intermediaries and loan servicers—would clearly eradicate much of that complexity. This could be accomplished using the existing Title IV delivery structure for student aid and thereby assuring even greater simplicity and administrative unity.

The commission's proposals with respect to the student loan programs are nearly identical to the ones in the Student Loan Reform Act of 1993. We strongly endorse income-contingent repayment as an important option for borrowers, allowing them greater repayment flexibility and encouraging loan forgiveness for public and community service.

We also propose improved accountability for all of the players in the system. And, of course, we endorse capitalizing the loan programs directly through the Federal Government, saving billions of dollars and greatly improving the delivery of all student aid.

Let me also note that the reaction to our final report was astounding, at least to me. I didn't expect anything to happen. But nearly all of the major higher education organizations produced written statements endorsing the key recommendations of our final report. Equally as important, virtually all of the bipartisan education leadership of the Congress attended the news conference at which we released this report.

I would like to take a few moments today to speak about what has happened since our report was released. Despite all that has happened since February, there still appears to be no viable alternative in the long run to direct lending. Direct lending's advantages are clear and significant. From the commission's perspective, student loans have become a major problem for students and their families.

Decreasing grants, increased loan burden, program complexity, and lack of certainty and accountability in the system have all contributed to the very serious national problem of access to higher education for all Americans. In the face of fiscal realities, direct lending provides a unique opportunity to simplify the entire student aid system, partly redress the grant-loan imbalance by easing repayment burdens through income-contingent payback and other flexible options, and put more of the limited dollars we actually have into the hands of students.

The commission believes there is no credible alternative to direct lending that both saves the more than $4 billion required under the budget resolution and has the support of the loan industry. Virtually every proposal offered to preserve the current program and save the $4 billion—including some that we have heard about today—have been rejected by the majority of the current loan industry.

I am reminded about the old joke about the economist stranded on an island with an unopened bottle of bear, who begins the search for a solution by saying, "Assume we have an opener." Mr. Chairman, we can't assume that over $4 billion cannot be saved or need not be saved; nor can we assume that an industry that cannot agree among themselves and has steadfast maintained for over a decade that the slightest trimming of yield would drain all capital from the program, will ever agree on changes as drastic as those required to cut over $4 billion from the program.

In short, Mr. Chairman, we cannot assume, especially at this late date, that the loan industry has an opener. They do not. More to the point, they do not have an alternative that will offer the savings and simplification of direct lending and still provide the $15 to $20 billion in loan capital required.

I am surprised that so many questions have been raised about direct lending's cost saving and delivery benefits. In addition to the Department of Education and the Office of Management and Budget, at least four independent creations of Congress—GAO, CBO, and the Advisory Committee on Student Financial Assistance, plus our commission—have told the Congress in very clear terms that direct lending will save money and simplify the program for students and institutions.

The majority of higher education associations representing chief executives of colleges and universities, and their National Association of Business Officers, support direct lending. This independent bipartisan commission supports direct lending. Numerous other parties, from student organizations to nonpartisan Government agencies, have also weighed in with their analyses of the cost saving and delivery benefits of direct lending.

In the commission's 2 years of hearings, seminars, and deliberations, we heard from no industry representatives recommending risk sharing, program consolidation, income-contingent repayment options, or reduced administrative costs. Nor did we receive words of encouragement from the industry for the current direct loan demonstration program, which it now enthusiastically supports.

It would be a shame to prolong this debate in the face of unyielding disagreement and lack of cooperation by the loan community. We all owe America's students more than that, Mr. Chairman. There is simply no realistic alternative to direct lending. It saves the required $4.2 billion. It simplifies the program for students and families. It has the support of the majority of the players. We recommend it to your committee and to the Senate.

Thank you for this opportunity to appear. I would be happy to answer any questions.

[The prepared statement of Mr. Witten follows:]

PREPARED STATEMENT OF R. MARSHALL WITTEN, ESQ.

Mr. Chairman and distinguished members of the Committee, thank you for the opportunity to testify on the Student Loan Reform Act of 1993. My name is Marshall Witten, and I appear before you today as a member of the National Commission on Responsibilities for Financing Postsecondary Education.

For the past three decades my professional life has been as an attorney in Bennington, VT. I also have been fortunate to have served in a variety of public service capacities, including as a member of the Vermont General Assembly and for the past 16 years as a member of the Vermont State Colleges Board of Trustees, 13 as its Chairman.

For those of you who may not be familiar with the Commission, let me give you a brief history. The Commission was created as part of the Higher Education Act reauthorization in 1986 through language crafted by Senator James Jeffords. It includes nine members appointed by the President, the Majority Leader of the Senate, and the Speaker of the House.

The Commission was given the daunting responsibility of determining a comprehensive strategy for long-term higher education financing policy. In trying to achieve that objective, the Commission met over a dozen times, hosted regional hearings, a national symposium, and seminars, and conducted extensive research on the problems of the current system as well as prospects for the future.

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Given the time constraints on us, I will not attempt to summarize the entire report for you today. However, I do want to observe that many of the key themes of our report are embodied in the Student Loan Reform Act of 1993. In particular, our report strongly endorses the concept of simplicity in determining eligibility and awarding all forms of student aid. Complexity of student aid programs is known to be a major barrier to access to higher education in this country, and a direct lending system—eliminating the thousands of lenders and radically reducing the number of intermediaries and loan servicers—would clearly eradicate much of that complexity. This could be accomplished using the existing Title IV delivery structure for student aid, thereby assuring even greater simplicity and administrative efficiency.

Our proposals with respect to the student loan programs are nearly identical to the ones that you and the President have forwarded via the Student Loan Reform Act of 1993. We strongly endorse income contingent repayment as an important option for borrowers, allowing them greater repayment flexibility and encouraging loan forgiveness for public and community service. We also propose improved accountability for all of the players in the system. And, of course, we endorse capitalizing the loan programs directly through the Federal Government, saving billions of dollars and greatly improving the delivery of all student aid as a result.

Let me also note that the reaction to our Final Report was astounding. Nearly all of the major higher education organizations produced written statements endorsing the key recommendations of our Final Report. Equally as important, virtually all of the bipartisan education leadership of the Congress attended the news conference at which we released the report.

I'd like to take a few moments today to speak about what has happened since our report was released. Despite all that has happened since February, there still appears to be no viable alternative in the long run to direct lending. Direct lending's advantages are clear and significant. From the Commission's perspective, student loans have become a major problem for students and their families. Decreasing grants, increased loan burden, program complexity, and lack of certainty in the aid system have all contributed to the very serious national problem of access to higher education for all Americans. In the face of fiscal realities, direct lending provides a unique opportunity to simplify the entire student aid system, ease repayment burdens through income contingent payback and other flexible options, and put more of the limited dollars we actually have into the hands of students.

The Commission believes there is no credible alternative to direct lending that both saves the more than $4 billion required under the Budget Resolution and has the support of the loan industry. Virtually every proposal offered to preserve the current program and save over $4 billion—including some that you may hear about today—has been rejected by the majority of the current loan industry.

I am reminded of the old joke about the economist stranded on an island with an unopened bottle of beer, who begins the search for a solution by saying "assume we have an opener!" Mr. Chairman, we can't assume that over $4 billion need not be saved. Nor can we assume that an industry that cannot agree among themselves, and has steadfastly maintained for over a decade that the slightest trimming of yield would drain all capital from the program, will ever agree on changes as drastic as those required to cut over $4 billion from the program. In short, Mr. Chairman, we cannot assume—especially at this late date—that the loan industry has an opener. They don't. More to the point, Mr. Chairman, they do not have an alternative that will offer the savings and simplification of direct lending—but still provide $15-$20 billion in loan capital required.

I am actually surprised that so much attention has been paid to the issue of direct lending's cost saving and delivery benefits. In addition to the Department of Education and the Office of Management and Budget, at least four independent creations of the Congress—GAO, CBO, the Advisory Committee on Student Financial Assistance, and our Commission—have told the Congress in very clear terms that direct lending will save money and simplify the program for students and institutions.

In the Commission's 2 years of hearings, seminars, and deliberations, we heard from no industry representatives recommending "risk sharing," program consolidation, income contingent repayment options, or reduced administrative costs. Nor did we receive words of encouragement from the industry for the current Direct Loan Demonstration Program, which it now enthusiastically supports. It thus seems clear to me that the proposals now being forwarded by various components of the loan industry are designed to delay the inevitable.

Mr. Chairman, the majority of associations representing chief executives of colleges and universities support direct lending. This independent, bipartisan Commission supports direct lending. Numerous other parties, from student organizations to non-partisan government agencies, have also weighed in with their analyses of the cost saving and delivery benefits of direct lending.

The worst mistake that we can make today is to prolong this debate in the face of entrenched, unyielding disagreement and lack of cooperation by the loan community. We all owe America's students more than that. Mr. Chairman, there is simply no realistic alternative to direct lending that saves the required $4.2 billion, simplifies the program for students and families, and has the support of the majority of players the way direct lending does.

I therefore urge that the Student Loan Reform Act of 1993 be implemented, without delay.

Thank you for this opportunity to appear before you. I would be pleased to answer any questions you may have.

Senator WELLSTONE. Senator Jeffords.

Senator JEFFORDS. Thank you. I just have one comment. I want to thank you for a very helpful statement, and to assure you that the rest of your report is being prepared in legislative form for the Congressional Report. Thank you.

Mr. Witten. Thank you, Senator.

Senator WELLSTONE. Mr. Witten, I think what we'll do is come back to your testimony, because it was very focused and very important, but I want to make sure, since we have a vote coming up, that everybody does get a chance to testify first.

Ms. Roemer.

Ms. ROEMER. Mr. Chairman and members of the committee, thank you for the opportunity to appear today. I am here on behalf of the National Association of Student Financial Aid Administrators, NASFAA, where I am that organization's chair-elect.

NASFAA understands the difficult decisions that you, as members of the committee on Labor and Human Resources, need to make regarding mandated reconciliation reductions to the Federal student loan programs. Recently, NASFAA's board of directors passed a resolution refining out organization's position on direct lending, and I wish to share with you NASFAA's concerns and recommendations.

In a communication with our membership about the board's direct lending resolution, NASFAA president Dallas Martin wrote: "During my time with the association, I cannot think of any other issue on which the association's members have had more differences of opinion than the case concerning direct lending. While recognizing there are many attractive features of direct lending, the board still believes that Congress should proceed with a parallel direct loan program of sufficient size and scope to allow for a complete evaluation before replacing the current Part B loan programs."

And I am sure you have heard enough today to know that there is a lot of discussion.

NASFAA realizes that if Congress elects to adopt this approach, it will be necessary to also adopt other legislative changes to the existing Part B loan programs in order to meet required budgetary savings mandated by reconciliation. We believe that a number of legislative changes to the current Part B programs, when added to the cost savings resulting from an expanded direct lending demonstration program, can satisfy those requirements.

Further, we would oppose legislative changes to the existing Part B loan programs that would result in any additional costs being incurred by students, or changes that would make the existing terms or conditions of these loans less favorable for borrowers.

Still, many of us recognize positive aspects of Federal direct lending. Changes that make it easier for students and parents to apply for and receive educational loans are strongly favored by our members. We also support provisions which would afford borrowers more repayment options, which in turn should enable them to reduce defaults and allow borrowers to consider lower-paying community service jobs.

Therefore, as a part of its resolution, NASFAA has produced a set of principles to guide a direct lending program. While time will not permit me to cover all, let me mention a few.

Under any program of student loan reform, there should be assurance of needed capital for student loans. While the program is an entitlement, and the Secretary is required to provide necessary moneys, the entitlement provision is not as strong as it could be. Many aid administrators question whether loan funds provided for the program's borrowers in the future will not be limited or delayed in some fashion. Many fear that Congress could at any time limit the total loan volume available to students, limit the growth of such volume, or ration student loan funds using other legislative devices.

We have heard about entitlement caps here this morning. Let me add, though, there is a significant magnitude of difference between possible entitlement caps on the growth of Part B loan program subsidies and caps on the growth of a direct loan program's total volume.

We also believe that in the direct lending program, the terms of loans to students and parents should be at a minimum as attractive as now is the case. The various missions, needs, responsibilities, and capabilities of postsecondary institutions should be considered in the design and implementation of any new program. The Federal Government should commit the necessary resources, administrative controls and management structures to administer any new program.

As previously noted, aid administrators have a lot of anxiety simply due to the fact that many aspects of the new program are unclear. Therefore, institutions are unsure of exactly how the new program will work, what will be required of schools, whether or not adequate levels of needed capital will be assured and delivered promptly, and what kind of financial liabilities institutions will face. In fact, the administration's bill and the reconciliation legislation reported by the House committee grant the Secretary wide authority to define Federal direct student loan programs. This broad, undefined secretarial discretion does little to ease campus aid administrators' anxieties.

The remaining anxiety is primarily based on doubts about whether or not the Department can develop, implement, and effectively manage all aspects of the program in a timely manner, in order to ensure that stated improvements become a reality. While our members have confidence in Secretary Riley and his administrative team at the Department of Education and sincerely believe they are working hard to improve the administrative operations within the Department, history has shown that under far less significant program transitions, things have been delayed, poorly implemented, and sometimes mismanaged.

Another principle we would like to address is that Federal savings produced in student loan reform should be used to fund student aid programs. As noted in my full statement, aid administrators are very concerned with the growing reliance on student loans and the continuing decline in funding for Federal Pell grants and other need-based programs. We believe that savings achieved through loan reform should be used to fund these other, critically important grant and work student aid programs. These are most important for our neediest students. Do not forsake them by reducing grant programs.

In addition to these principles, as NASFAA chair-elect, I want to voice my sadness that this debate has all too often fallen away from a discussion of merits or problems. Too often, the debate has fallen into character assassination and questioning of motives. I can say that NASFAA reaches its decisions independently and listens to the views of its members. As professionals, my colleagues and I resent suggestions that we cannot administer a direct lending program. We can. We need your support, though, support from the Federal Government in many forms, from the creation of common sense regulations and program requirements to training and timely assistance when we have questions.

In conclusion, if Congress should decide to phase in direct lending, I want to assure you that the student financial aid administrators, to the best of their abilities and with good faith efforts, intend to see that the Federal direct student loan program works to serve students and their families. We have no desire to see any program designed to assist in providing educational opportunity fail or flounder. We have no desire to wish to undermine any such program.

I have candidly expressed my concerns, and I hope you will listen to our advice. With our commitment to students, no one gains if students are hindered in the pursuit of obtaining a postsecondary education.

Thank you.

[The prepared statement of Ms. Roemer follows:]

PREPARED STATEMENT OF CLAIRE ROEMER

Mr. Chairman and members of the committee, I appreciate the opportunity to testify at this Senate hearing. My name is Claire Roemer and I am the student financial aid district coordinator for the Tarrant County Junior College District headquartered in Fort Worth, TX. I also represent the National Association of Student Financial Aid Administrators (NASFAA) where I am the organization's chair-elect. NASFAA is the largest association of student financial aid professionals in the country and represents more than 3,100 postsecondary institutions.

The Tarrant County Junior College District has a Fall or Spring enrollment that normally exceeds 28,000 students. Our 2-year public community college has an average tuition and fee charges for full-time students of $232 per semester and we have no on-campus housing. Because our student charges are low, there is not a great emphasis on borrowing and we actively discourage students from taking out loans to finance their education if it can be avoided. Consequently, only about 850 of our students participated in the Federal Part B student loan programs in 1992-93. We have never participated in the Federal Perkins Loan Program, because of our low student charges and the school did not wish to become involved in student loan collections. NASFAA, on the other hand, represents many institutions that depend very heavily upon student loan programs in order to help students to finance their education.

NASFAA understands the difficult decisions that you, as members of the Committee on Labor and Human Resources, need to make regarding mandated Reconciliation reductions to the Federal student loan programs. Recently, NASFAA's Board of Directors passed a resolution defining our organization's position on direct lending and I wish to share with you NASFAA's concerns and recommendations.

In a communication with our membership about the Board's direct lending resolution, NASFAA President Dallas Martin wrote, "During my time with the Association, I can not think of any other issue on which the Association's members have had more differences of opinion than the case concerning direct lending. Some members strongly favor moving quickly into a full-scale direct lending program, others are opposed. It is my sense, as reflected in the Board of Directors' resolution, that a majority of members have a great deal of uncertainty and anxiety about making such a change too quickly when much is still unknown. For this reason, the Board still believes that Congress should proceed with a parallel direct loan program of sufficient size and scope to allow for a complete evaluation before replacing current Part B loan programs."

"Some members have told me they believe it is politically naive of the Association to advance such a position in light of the Administration's strong support for direct lending, and the need for Congress to come up with $4 billion in student loan savings due to budget reconciliation. Other members, however, believe that additional savings can be realized by making changes to the existing Part B Federal Family Educational Loan Programs, and when coupled with some Savings from a direct loan demonstration program, would enable Congress to meet the budget requirements. These people further believe that given the importance of the existing student loan programs for their students, it would be unwise to proceed too quickly with direct lending until the Department of Education has had a chance to develop, fully-implement, and test the operational structure necessary to effectively administer a full-scale national program.

"Given these differing views, the Board of Directors' resolution on direct lending attempts to advance several important principles that should guide any direct lending program while still suggesting caution in proceeding too quickly."

As NASFAA chair-elect, I want to voice my sadness that this debate has all too often fallen away from a discussion of the merits or problems with direct lending. Instead some individuals on each side of the debate have made charges and countercharges often with a disregard for the truth or reality. All too often, the debate has fallen into character assassination, questioning of motives, and plain bad manners. Accusations that one group has bought another, or one group or another is naive and will be punished politically deserve no place in your deliberations. I can say that NASFAA reaches its decisions independently and listens to the views of its members. While we have taken a position consistent with the views of a majority of our members, we still respect the opinions and views of all of our members and have tried to advance a position that provides reasonable accommodations for those on both sides of this important issue.

Let me first describe, from our perspective, the environment in which the direct lending debate is taking place. I also want to portray how many student financial aid administrators view several changes in Federal student aid policy since the Reauthorization of the Higher Education Act was signed into law 10 months ago. There are changes contained in that Act as well as some changes proposed by the Administration that trouble financial aid administrators.

As student aid administrators, I know that I, and most of my colleagues, evaluate all modifications to Federal student aid policy by giving primary consideration to the benefits or disadvantages any change may have on the ability of our needy students to have sufficient support from the government to obtain a quality postsecondary education. Furthering educational opportunity is our overriding interest, and providing students with good service is our first goal.

Many of the revisions contained in last year's Reauthorization law were long overdue and represent substantial progress in improving the Federal student aid programs and making the system easier and more understandable for students and parents. At the same time, institutions have not had an easy time understanding or implementing a number of the changes. Part of the difficulty institutions encountered was simply due to the immediate implementation effective dates on many provisions that required schools to change procedures and processes. However, an even bigger problem has been in obtaining guidance and assurances from the Education

Department on what institutions can and cannot do. And, while we also understand the pressure and operational constraints imposed upon the Department of Education to implement the new law, it too has been slow in developing rules and regulations that are of use to institutions in realizing the policies mandated by the Congress. Regrettably, there are still many provisions of the Act which are confusing, unclear, or contradictory. This is why we have been urging quick consideration of Technical Amendments legislation and hope that this Committee will give favorable consideration to NASFAA's recommended technical amendments.

Another area that impacts the current student aid debate among aid administrators are the need analysis changes made in the Act's treatment of single independent students and dependent students that work. These changes affect primarily Federal Pell Grant recipients. NASFAA understands there were real problems in this area that the Congress proposed to solve, however, the unintended result of some of these changes, according to the American Council on Education, will be that "some 525,000 students above the age of 24 with no parental income to rely upon will find their eligibility has been eliminated, and another 675,000 will find their awards reduced by an average of $630 as a result of the new rules. Many of these who will be affected are single parents trying to raise a family, maintain a job and get an education all at the same time." This elimination or reduction of Federal Pell Grant awards concerns many aid administrators. We have already seen this occur at my institution. As an example, I know of one student who was eligible for a Pell Grant of $1,710 in 1992–93 and was eligible for only $650 for 1993–94. While a solution to this problem does not appear imminent, NASFAA does want to acknowledge and thank the several Senate staff members who have attempted to find and broker a compromise in this area.

A third decisive issue in the thinking for many of our members is the failure to date to redress the grant/loan imbalance in Reauthorization of the Act or through the Appropriations process. I want to thank those members of this committee that last year supported establishing the Federal Pell Grant Program as a student entitlement. If the entitlement proposal had survived the legislative process, students would now have Federal Pell Grants funded at a level authorized by the Act. Further, those eligible students' funds would be guaranteed and they would not have to worry about reductions due to shortfalls. As you know, the maximum Federal Pell Grant was reduced by $100 in FY-93 to $2,300 and we expect it to stay at that lower level in FY-94. The Congress, however, authorized a maximum Federal Pell Grant of $3,700 for FY-93 and $3,900 for FY-94. Institutional financial aid administrators have had the unenviable task of explaining to students and parents the differences between authorized maximum amounts as opposed to appropriated maximum amounts. The perception of many students last summer, after the Higher Education Act was passed, was that they would be receiving larger Pell Grants for this coming year. But unfortunately, we have had to tell them that this is not the case and that in fact in many cases they will get less money. That is why we continue to strongly hold the belief that a Federal Pell Grant entitlement is the only method to close the grant/loan imbalance and to reduce inappropriate borrowing by some classes of students.

Our anxiety with the grant/loan imbalance is further heightened by the $2 billion Federal Pell Grant shortfall that has accumulated over the last several years. We applaud the efforts of the Administration for including in its stimulus package the budget authority to wipe out this shortfall and start with a clean slate. We continue to hope a solution to the Federal Pell Grant shortfall can be found that does not penalize students by reducing their grants or program eligibility, or reduce funding for current and future year Title IV appropriations.

Finally, student aid administrators are very concerned with the budget proposed by the Administration. NASFAA believes it extremely unfortunate that the Administration has chosen to submit a proposed FY 1994 student aid budget request that substantially reduces educational opportunities for our citizens. Regrettably, the Administration has proposed a budget with a $200 million cut in FY 1994 and subsequent reductions for the future in the Federal campus-based programs (the Federal Supplemental Educational Opportunity Grants, the Federal Work-Study, and the Federal Perkins Loan programs), the elimination of the State Student Incentive Grant Program, and several other suggested modifications to the Higher Education Act which all combine to hurt students.

This harm will take several forms if the proposed budget is enacted by the Congress. Already these programs are under-funded and further reductions will cause students to drop out or scale back their postsecondary educational programs, or will lead such students to assume even greater student loan burdens.

Given these factors, and all of the uncertainty, it is perhaps somewhat understandable why many financial aid administrators are less than enthusiastic about now considering converting the current Part B student loan programs into a phased-in system of direct lending.

Still, most of us recognize there are many positive aspects of the Federal direct lending concept which the administration has proposed. Changes that make it easier for students and parents to apply and receive educational loans are strongly favored by our members. We also support the provisions which would afford borrowers more repayment options which, in turn, should help to reduce defaults and allow borrowers to consider lower-paying community service jobs.

At the same time, a majority of our members have a great deal of anxiety about phasing out the current Part B Federal Family Education Loan programs and replacing them so quickly with an untested full-scale direct lending program. Part of this anxiety is simply due to the fact that many aspects of the new program are still unclear. Therefore, institutions are unsure of exactly how the new program will work, what will be required of schools, whether or not adequate levels of needed capital will be assured and delivered promptly, and what kind of financial liability institutions will face. In fact, the Administration's bill, and the Reconciliation legislation reported by the House Committee on Education and Labor, grant the Secretary of Education wide authority to defame Federal Direct Student Loan Program.

This broad, undefined Secretarial discretion does little to ease campus aid administrators' anxiety concerning how the new program will work and what will be required of schools. The Secretary has the authority, for example, to determine which postsecondary institutions may participate in the Federal Direct Student Loan Program and how such participants may be terminated from the program; to determine what the program-wide average for the administrative fee to institutions may be (also aid administrators are troubled by the knowledge that Congress in the past has eliminated such fees paid to schools); to determine the terms of participation and origination agreements; to set the terms and conditions for the various repayment options and possibly allow for negative amortization in some repayment plans; to set the terms and conditions for borrower's who wish to change repayment plans; to determine the percentage of annual income an EXCEL Account borrower must repay; to determine borrower defenses; to waive regulatory protections of the General Education Provisions Act for 1 year; to have almost unlimited authority over the current loan system during the transition; and to set institutional liability rules without statutory limitation.

Another source of major concern is whether or not adequate levels of needed capital will be assured and delivered promptly. There are three aspects of the adequate capital debate that cause some discomfort. First, while the program is an entitlement and the Secretary is required to provide necessary monies, the entitlement provision is not as strong as it could be. The legislation should be modified so that students eligible for the Federal Direct Student Loan Program "shall be deemed to have a contractual right against the United States to receive any loan under this part for which they are eligible." Second, while alternative originators are provided for those postsecondary institutions that do not wish to make Federal Direct Student Loans themselves, it is not clear in the legislation that timely delivery of funds to students is ensured nor is it clear what bureaucratic hoops institutions must jump through in order to receive funds from alternative originators. Third, and despite assurances from proponents, many aid administrators question whether loan funds provided for the program's borrowers, in the future, will not be limited or delayed in some fashion. This concern stems from the fact that loan funds could be delayed by failure to pass an appropriation bill or failure to pass extension of debt ceiling legislation. Such delays may be only a few days, but a student would still be waiting for their loan check. Even more unsettling to many in the student aid community is the knowledge that Congress could, at any time, limit the total loan volume available to students, limit the growth of such volume, or ration student loans funds using other legislative devices. This could occur if the Congress and the President agreed to government-wide program entitlement caps that would affect the Federal Direct Student Loan Program. It could also occur if the Congress or the States, by the usual constitutional route, adopted a balanced-budget constitutional amendment and the Supreme Court, upon finding spending was greater than revenues, might order a reduction in loan volume for any given year. One can say these concerns are far-fetched, but experience has shown us that the Congress has given benefits and taken them back with regularity. NASFAA will concede the argument that nothing could prevent this situation now under the current Part B loan programs. However, there is a significant magnitude of difference between possible entitlement caps on the growth of Part B loan programs subsidies and caps on the growth of a direct loan program's total volume.

The remaining anxiety is primarily based on doubts of whether or not the Department of Education can develop, implement, and effectively manage all aspects of the program in a timely manner in order to ensure that the stated improvements become a reality. While our members have confidence in Secretary Riley and his administrative team at the Department of Education, and sincerely believe they are working hard to improve the administrative operations within the Department, history has shown that under far less significant program transitions within the Department, things have been delayed, poorly implemented, and mismanaged.

As examples, I would cite the frustration aid administrators have in receiving timely information on program requirements. It took 5 years after the last Higher Education Act Reauthorization for the Department to issue Part B regulations. The situation was so intolerable that last year the Congress placed a drop dead provision in the 1992 Amendments to force timely issuance of Part B regulations. Even after regulations are issued, it is difficult to get interpretations from the Department concerning how to handle certain situations. Regional Department personnel all too often cannot provide answers and even Washington Department personnel cannot provide timely rulings or offer any guidance to help students with special circumstances. Even this Committee sanctioned a provision in the 1992 Amendments that mandates "The Secretary shall review the regulations of the Department and the application of such regulations to ensure the uniformity of interpretation and application of the regulations." I would be surprised if there was no Senator on this Committee that, at one time or another, has not had to intercede with the Department on behalf of an eligible student or institution that had a problem with the Department's interpretation of program regulations or some other aspect of the Title IV programs.

I will grant that NASFAA, with a widely divergent membership, has among its members those who are strong advocates of the Federal Direct Student Loan Program, as well as those who are just as adamantly opposed to its creation. The majority of our members, however, would favor maintaining and improving the existing Part B loan program structure and authorizing a direct lending demonstration program that would allow all schools who desire to participate to do so, and/or allow institutions the option of offering Federal direct loans to first-time borrowers in order to review the effectiveness of each approach. At Tarrant County Junior College, I operate in an environment of eight secondary markets and frequent bank failures and mergers. To permit new borrowers access and let others finish under the existing structure would simplify the need for consolidation. It would also allow sufficient time for the Department of Education to develop, evaluate the benefits, and put in place all of the administrative systems needed to adequately operate a national, full-scale direct lending program.

NASFAA realizes if Congress elects to adopt this approach, it will be necessary to also adopt other legislative changes to the existing Part B student loan programs in order to meet the required budgetary savings mandated by the Reconciliation reductions. We believe that a number of legislative changes to the current Part B programs, when added to the cost savings resulting from an expanded direct lending demonstration program, can satisfy the budget requirements. Further, we would oppose legislative changes to the existing Part B loan programs that would result in any additional cost being incurred by students or changes that would make the existing terms or conditions of these loans less favorable for borrowers.

In approving this position for the organization, our Board of Directors gave careful consideration to all arguments, pro and con, concerning direct lending. This is not a new debate. Except for a change in Administrations, nothing has changed in the last 18 months that fundamentally answers the concerns of many in the financial aid community regarding a fully-implemented phase-in of direct lending versus the need to test the concept in a demonstration project. Indeed, we now see some financial aid administrators who previously supported direct lending change their positions, since their support was conditioned on two premises. 1), that a phase-in of direct lending would allow for even greater expansion of loan limits than was adopted in the 1992 Act; and 2), that the savings provided by adoption of direct lending would be transferred to increase funding of the Federal Pell Grant and campus-based student aid programs. Substantial increases in loan limits and transference of loan savings to the grant programs did not transpire last year and will not happen with the possible adoption this year of the Federal Direct Student Loan Program.

Still our members realize that there are a number of very positive features to a direct lending approach and would welcome such changes to the Federal loan programs. We also realize you must achieve the required Reconciliation savings, and analysis done by OMB and CBO suggest that adoption of a Federal Direct Student Loan Program can substantially help to achieve a major portion of these savings. Therefore, if the Congress decides to proceed with direct lending, NASFAA believes that very careful consideration should be given to developing and implementing such a program. Therefore, as a part of its resolution, NASFAA has produced a set of principles to guide a direct lending program. We encourage you and your colleagues to carefully consider our recommended principles and associated concerns and give them primary consideration as you write your Reconciliation legislation.

These principles are as follows:

1) NASFAA believes it to be essential that:

a) Under any program of student loan reform, there be assurance of needed capital for student loans.

b) The terms of loans to students/parents be, at a minimum, as attractive as is now the case.

c) The various missions, needs, responsibilities, and capabilities of postsecondary institutions be considered in the design and implementation of any new program.

d) The Federal Government commit the necessary resources, administrative controls, and management structures to administer any new program.

e) Federal savings produced in student loan reform be used to fund student aid programs.

2) In any implementation of direct lending, NASFAA believes primary considerations must include:

a) Prompt delivery of funds for students without disruption or interruption.

b) Simplicity for the applicant, as central to the program.

c) A system in which each borrower has loans serviced in an efficient, centralized, and comprehensive manner that provides the borrower with accurate account information and a clear understanding of repayment requirements.

d) A consolidation option, without penalty, for all students who have borrowed under the Direct Loan or Federal Family Education Loan (FFEL) programs.

e) A provision for the current FFEL student loan system to continue to meet the credit needs for students and families during the transition.

f) Simplification of current operational procedures.

g) Training and support provided by the Federal Government for all aspects of the program.

h) Legislative language authorizing and defining direct lending which is as explicit as possible.

i) Consultation and participation of student financial aid administrators, fiscal officers, and others directly involved in the administration of the student financial aid programs at the campus level in the development of legislation, regulations, and operational implementation of direct lending.

j) The development, communication, and consistent application of reasonable and clear criteria for assessing institutional liability.

k) A fully operational National Student Loan Data System.

l) The development of consumer information and counseling materials by the Department of Education in consultation with postsecondary institutions.

m) An administrative allowance to be paid to postsecondary institutions for the costs they incur in administering the program.

n) Electronic technologies to streamline system requirements and a system design to reflect the diverse technological configurations in the computing environment.

o) The ability of participating institutions to offer direct loans to first-time borrowers and FFEL program loans to continuing borrowers during the transition.

p) A voluntary cohort for the initial year of the transition.

q) Alternative loan origination systems or organizations.

Any proposed direct lending program should, we believe, take serious cognizance of these principles to ensure the program benefits students primarily and is administratively sound. Further, these primary considerations are important in implementing a direct lending program so that it is sensitive not only to student concerns, but also institutional ones.

As professionals, my colleagues and I resent suggestions that we cannot administer a direct lending program. We can. But, we need support from the Federal Government in many forms from the creation of common sense regulations and program requirements to training and timely assistance when we have questions. And, we will need support from the Congress to not forsake our neediest students by reducing or starving the grant aid programs and to not take any action that will have the effect of limiting all the monies necessary for borrowers' needs in the Federal Direct Student Loan Program.

Let me also mention, NASFAA has a rapid survey network which is composed of a statistically representative sample of our member institutions. We recently have utilized it to gather information on a number of questions about direct lending. When the results are available we will share them with the Congress and this Committee. We hope this information also will be of some assistance in you deliberations. A copy of that survey is attached to my formal statement.

In summary, we urge you to proceed carefully and to give careful consideration to the options we have suggested. We believe that before adopting a Reconciliation plan that would lead to full implementation of a system of direct lending you should first consider a possible expanded demonstration program for all who want to participate and couple that with alternative Part B student loan savings plans. Such plans, however, should neither harm students nor schools or the continued viability of the Part B loan programs; nor should they result in reductions in other need-based student aid programs.

The position we have taken on direct lending comes from our genuine and sincere concern for providing educational opportunities for our Nation's students and their families. To do what we believe is right for students and families, NASFAA urges you to seriously consider our position on these matters, and to please contact us if you have any questions or if we can assist you further.

If the Congress should decide to phase-in direct lending, I want to assure you that student financial aid administrators, to the best of our abilities and with good faith efforts, intend to see that the Federal Direct Student Loan Program works to serve students and their families. We have no desire in seeing any program designed to assist in providing educational opportunity to fail or flounder. We have no wish to undermine any such program.

We have candidly expressed our concerns and we hope the Congress will heed our advice. If there are problems in the implementation of the Federal Direct Student Loan Program, no one will be able to say it was sabotaged by student financial aid administrators. With our commitment of service to students, no one gains if students are hindered in their goal of obtaining a postsecondary education.

NASFAA Rapid Survey Network **1992-93 RSN Survey #3**

Direct Lending Issues **May 18, 1993**

Please indicate your response to each question in the space provided and return the completed survey within 48 hours via FAX #202-785-1487 (Attn: Fred Franko) or in the enclosed envelope. Thank you for your participation.

1. Given the structure and procedures outlined in the 4/2/93 Federal Direct Student Loan Program (Federal Direct Loan) Notice of Proposed Rulemaking (NPRM), which of the following best describes your school's current plans? (check one)

___ My school will apply to participate in the demonstration program.

___ My school is considering application to participate in the demonstration program.

___ My school will not apply to participate in the demonstration program.

___ We do not have enough information to make this decision at this time.

2. The 4/2/93 Federal Direct Loan NPRM stated that the following would be required for participation in the demonstration program: A) IBM compatible PC, 512 RAM, DOS version 3.3 or later, 4 MB space available on a hard disk, a floppy drive, and a 1200, 2400, or 9600 baud Hayes compatible asynchronous modem; or B) a mainframe computer supporting IBM 3780 RJE protocol and HASP using binary synchronous communications at 2400 and 4800 bits/second; and C) a printer that prints on 8-1/2 by 11 inch paper.

a. Do you have this equipment available for your use?

___ Yes ___ No

b. If no, can you acquire this equipment by July 1, 1994?

___ Yes ___ No

c. If no, can you acquire this equipment by July 1, 1995?

___ Yes ___ No

3. The Administration's direct loan proposal would permit institutions to originate loans or other entities to originate loans on behalf of eligible institutions. Given this option, if your school was selected for participation in a direct loan program, which of the following best describes your current plans regarding direct loan origination? (check one)

___ My school would originate loans.

___ My school would not originate loans.

___ We do not have enough information to make this decision at this time.

Note. for questions 4-6, please just provide your best estimates; there is no need to consult your records or perform any calculations.

4. Please estimate the approximate number of Federal Perkins Loans your school makes annually.

Number of Perkins Loans: ________________

5. Please estimate the approximate number of FFELP (Federal Stafford, FSLS, and FFLUS) loans your school certifies annually.

Number of FFELP loans: ________________

6. The Administration's direct loan proposal authorizes a loan origination fee averaging $10 per borrower per year for loan originators. Given your understanding of the administrative responsibilities of institutions as outlined in the 4/2/93 Federal Direct Loan NPRM, which of the following amounts most closely approximates the costs that your school would incur in originating a direct loan to a student? (check one)

___ Less than $5 ___ $5 to $10

___ $11 to $15 ___ $16 to $20

___ $21 to $25 ___ $26 to $30

___ More than $30

___ Insufficient information to estimate at this time

7. During any implementation or transition period, both the Federal Direct Loan Program and the FFEL programs would continue to operate. Under both the 4/2/93 Federal Direct Loan NPRM and the Administration's proposal, schools selected for participation in a direct loan program would no longer be allowed to make FFEL loans to their students. If the FFEL program is phased out as proposed by the Administration, which of the following options would you favor? (check one)

___ Schools should be limited to either a direct loan program or the FFEL program.

___ Schools should be allowed to participate in both programs until such time as the FFEL program is phased out.

(Please continue on side 2)

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Page 2

8. If schools were allowed to participate in both programs at the same time, which of the following would you favor? (check one)

___ First year students be awarded Federal Direct Loans; all other students stay in FFELP.

___ New borrowers be awarded Federal Direct Loans; old borrowers stay in FFELP.

___ Undergraduate students be awarded Federal Direct Loans; graduate students stay in FFELP.

___ Schools are allowed to make this determination.

9. The Department of Education plans to issue a contract (or contracts) for servicing and collecting Federal Direct Loans. One goal is for each student to have only one servicer for all his/her loans. This may mean that schools will deal with more than one servicer. If possible, would you like to choose the servicer for your school, even if that choice may mean a servicer change for some transfer students?

___ Yes ___ No ___ Not sure

10. The following are some of the issues that have been raised relative to direct lending. Please indicate your school's reaction to these issues, using a scale of 1-5 where 1 = unconcerned, 2 = somewhat concerned, 3 = concerned, 4 = very concerned, and 5 = greatly concerned.

1 2 3 4 5 Timing of funds delivery to schools

1 2 3 4 5 Assurance of program funding

1 2 3 4 5 Schools' administrative ability to originate loans

1 2 3 4 5 Schools' administrative ability to disburse loans

1 2 3 4 5 Schools' administrative ability to reconcile loans

1 2 3 4 5 Schools' potential liability

1 2 3 4 5 Ability of ED to issue regulations in a timely manner

1 2 3 4 5 Ability of ED to provide training and support

1 2 3 4 5 Loan collections and servicing by ED contractor

1 2 3 4 5 Loss of services currently provided by lenders

11. Given all of the discussion surrounding direct lending, which of the following most accurately represents your feelings on this issue? (check one)

___ I would favor a phased in direct lending program to replace FFELP.

___ I would favor a parallel direct lending demonstration program to evaluate its effectiveness before phasing out FFELP.

___ I would favor retaining the existing FFELP, but working to improve it and make it more cost effective.

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Senator **WELLSTONE**. Ms. Roemer, thank you very very powerful testimony.

Mr. Atwell.

Mr. **ATWELL**. Mr. Chairman, because of the lateness of the hour, I'd like my written testimony, with your permission, to be entered in the record, and I would like to make five simple points.

Senator **WELLSTONE**. Without objection, it will be included in the record as if read.

Mr. **ATWELL**. First, it seems to me that sticking with the present system is not an option because of the mandate in your own budget resolution to save $4.3 billion in reconciliation. There may be—indeed, there are—other ways to save that $4.3 billion, but most of those would require passing additional costs on to borrowers, and we would not favor that. So in our view, S. 920 proposes a careful and thoughtful approach to achieving full-scale conversion to direct lending over 5 years, and indeed it is the best opportunity in nearly 30 years to streamline the Federal loan system.

I would compliment Secretary Riley and deputy secretary Kunin for listening to the concerns of the higher education community and modifying their proposed legislation as it was developed.

My second point—the legislation is not perfect, and it can be and should be strengthened and improved, first, by capping the origination fee at 5 percent as was the case in the House bill; second, requiring the Secretary to consult with the higher education community before promulgating regulations; and third, the income-contingent, or EXEL repayment option, is excessively vague on some of the terms and conditions of repayment. No one should incur negative amortization, and no one should pay back more than the principal and interest owed, and no one should have payments stretched out over as long as 40 years, as in the proposal and as was discussed earlier.

My third point. This legislation can and will benefit students in several ways. First, the lower interest rate downstream. And there are ways to get that interest rate even lower, as I will suggest in a moment. Second, it eliminates the pressure which the present system has for students to borrow the maximum amount when they may not need it. Third, you have a simplified system with one-stop shopping for students. Also, you have lower origination fees.

On the matter of origination fees, to clarify something that was brought up earlier in testimony, those fees range from zero—the origination fee is 5 percent, but in addition to the origination fee, there is a reinsurance fee of zero to 3 percent, so some students would pay 8 percent. In Massachusetts, I understand that to be 7.5 percent.

Fourth, to those who say that we should stick with the present system until the demonstration authorized in the 1992 reauthorization is evaluated, I would say first, without the prospect of a full-scale move to direct lending, those opposing it because they profit from the present system would never have come forth with proposals to squeeze excessive profits out of the system; and in the absence of a very substantial direct loan alternative, they can be expected to come back in a year or two, saying they misjudged how much cutting they could absorb, and the Government would at that point have few alternatives but to accede.

Second, at the request of those with a vested interest, excessive restrictions were written into the demonstration project, and as a result, as deputy secretary Kunin brought out so well in her testimony, it would take you 10 years to get a valid demonstration.

Third, in addition to squeezing excess profits out of the system, to achieve the required savings would probably require passing additional costs on to borrowers.

I do agree with those who support squeezing profits out of the existing system to the extent that I think that should be done, along with direct lending, during the next 5 years, when there will be an estimated $100 billion of borrowing, only $50 billion of which would be direct lending. So it seems to me that you ought to do both, in other words,

Fifth, much has been made of the fact that the higher education community appears to be divided on the issue. My responses are that, first, there are legitimate concerns about the capacity of the Department of Education to administer the program, and very legitimate concerns about whether there will be delays in getting loans to students and getting the loan funds made available to institutions. I believe the Department of Education leadership is fully committed to doing what is necessary to make the program work, and they have the opportunity, of course, to contract with some of the present players where appropriate. And I think that deputy secretary Kunin's testimony on that this morning was very powerful. We must remember that the present Federal Family Education Loan programs are hardly models of good administration, as has been brought out here.

Further, Perkins loans are direct loans, and they are generally well-administered by the institutions, and this program comes the closest to the model of the direct loan proposal.

Also, not well understood by many of our constituents—and we are taking steps to see that they are better informed—is that the proposal allows qualified institutions to decide whether or not they want to originate loans. If they do, the system should work much like the Perkins program, and if they don't, the Government would bear the cost of alternative origination.

And finally, and perhaps as important as any other point I could make, many of the doubts within our institutions arise in part by the heavy-handed lobbying of those with a vested interest in the current programs.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Atwell follows:]

PREPARED STATEMENT OF ROBERT H. ATWELL

Mr. Chairman and members of the committee, I am Robert Atwell, president of the American Council on Education, and I am pleased to be here today to present the views of 12 higher education associations regarding S. 920, the Student Loan Reform Act of 1993.

As you know, the higher education community strongly supported the Direct Loan Demonstration program adopted as part of the recent Higher Education Act reauthorization. Our hope then was that such a program would pave the way for replacing bank-based loans altogether in the next reauthorization. The gradual pace of this phase-in was a deliberate strategy to overcome concerns about the efficacy of such a system, and to retain stability and ensure continuity of student access to loans. Moreover, in light of the Bush administration's opposition to the demonstration program, it was not feasible last year to seek enactment of a larger direct lending program.

The requirement in the Budget Resolution to save $4.3 billion in reconciliation means that the existing federal student loan program is about to undergo major changes. Simply preserving the Federal Family Education Loan Program in its current form is not an option. The need to make these changes provides an opportunity to streamline student loans in a way that better serves students and their families, colleges and universities, and taxpayers. In our judgment, S. 920 proposes a careful and thoughtful approach to achieving a full-scale conversion to universal direct lending over a 4-year period, and we believe it deserves your support. A properly executed direct lending program would accomplish the goal of making loans an entitlement to students, rather than to the private organizations that now exist to deliver and service them.

Congress constructed the Guaranteed Student Loan (GSL) program in 1965 around a vastly different set of operating assumptions than the conditions surrounding the program today. The GSL was conceived initially as a loan to middle-income students with minimal Federal subsidy, while the goal of ensuring access to college for financially disadvantaged students was addressed through grant assistance. Over time, these historic distinctions have blurred as need-based grant awards lost value relative to inflation, family savings rates declined, and budget policies favored the growth of mandatory programs.

As a result, loans have grown in prominence to the extent that they now play a central role in providing educational access for students in all income categories. It is estimated that 5.5 million new federally guaranteed student loans totaling $18 billion will be issued in fiscal year 1994. While lenders initially had to be induced to issue loans to students with the promise of a guaranteed profit margin, dramatic increases in loan volume have boosted the profitability of student loans and increased their popularity among the lending community.

This tremendous increase in loan volume has been accompanied by an explosive growth not only in profits, but also in players in the program. Millions of borrowers, 10,000 lenders, 46 guaranty agencies, and 44 secondary markets serving 6,500 postsecondary institutions now participate in the guaranteed loan system. In short, the current program has developed into a system that is cumbersome and expensive to maintain.

The fiscal year 1994 budget resolution adopted by Congress—with its reconciliation instructions to achieve over $4 billion in savings from the Federal Family Education Loan Program—ensures that dramatic changes are in store for loans. Savings can be achieved by means other than conversion to direct lending, and other proposals have been advanced for this purpose. However, we believe that S. 920 represents the best opportunity in 28 years to streamline the Federal student loan system for students and schools, to offer students a variety of repayment options, and to better integrate policy considerations regarding loans into the overall Title IV framework.

Anticipating that the Clinton administration would submit direct loan legislation to Congress, the higher education community several months ago developed a set of key elements by which to measure legislative proposals to secure broad-scale direct lending. We are pleased that S. 920 incorporates most of these elements. Among them are the following:

- Loans would continue to operate as an entitlement, and continuous access to capital would be provided during the transition to direct lending.
- No institution would be required to become a direct lender or to originate loans. The Department of Education would absorb the costs of providing loan origination services for institutions that desired them through an independent contractor.
- Institutions would bear no responsibility for servicing loans. The Department of Education would provide for this function under contract arrangement, at no cost to institutions.
- Institutions approved as loan originators would be reimbursed for the marginal costs of origination, at a rate yet to be determined.
- Borrowers would be offered a range of repayment options, including income-contingent repayment.

Mr. Chairman, our analysis of S. 920 also yields a number of suggestions for ways in which the legislation can be strengthened and improved. We urge that you consider amending the bill to include the following modifications:

First, the bill would let the Secretary of Education charge borrowers an administrative fee of between 5 and 6.5 percent. If the need for such a fee can be demonstrated, we believe that it should be capped at 5 percent or eliminated. The House bill incorporates such a modification.

Second, we have reservations about waiving, for the first year of the program, the General Education Provisions Act requirements that govern rulemaking procedures. We believe that the smoothest, most trouble-free implementation of any new Federal program will occur if all participants have a full opportunity to take part in the development of regulations that will shape the program. The Department of Education maintains that it will not have time to publish regulations in the Federal Register and allow the opportunity for public comment before the law takes effect on July 1, 1994. while we are sympathetic to these concerns, we believe that the law should provide for formal consultation with institutions of higher education and students before potentially burdensome regulations are imposed.

A further area of concern is that the bill is far too vague with respect to a number of critical provisions, such as the terms and conditions of income-contingent repayment. We believe borrowers who select income-contingent repayment should not incur negative amortization, should not pay back more than the principal and interest owed, and should not have payments stretched out over a too lengthy period of time, such as the 40 years suggested by the administration. The income-contingent repayment plan should be much more precisely specified in the statute, and the length of repayment should not exceed 20 years.

Change is often difficult to embrace, and I would mislead you if I were to imply that support for direct lending within the higher education community is unanimous. Some members of the community are reluctant to abandon the familiarity of the current program for an untested direct lending program. To a considerable extent, this hesitation is attributable to the concerted effort that has been made by opponents of S. 920 to flood college presidents, financial aid administrators, and even students with misleading information about the consequences of the President's proposal. The effort to confuse students about the impact of direct lending is especially irresponsible: student behavior is too easily influenced by bad news, as was demonstrated in 1980 when financial aid applications dropped precipitously in response to widespread news stories about the likelihood of cuts in Federal student aid—cuts that were recommended by the Reagan administration but not adopted by the Congress.

The undersigned associations have provided accurate information to their members about the legislation. In recent weeks, we have stepped up these efforts. Each opportunity we have had to speak directly to our members about the bill confirms our sense that the concerns that have been fostered are readily dispelled with accurate information about what is being contemplated. Also helpful is the paper entitled "Let's Take Back Student Aid: Direct Lending Issues and Myths," by financial aid administrators Kay Jacks of Colorado State University and Jerry Sullivan of the University of Colorado, which has been distributed to all public 4-year institutions and to each member of the U.S. Senate. I have attached this paper to my testimony. I would call the Committee's attention especially to the "myths about direct lending" section of their report.

In conclusion, I would like to express our view that S. 920, with some modifications, offers an excellent chance to accomplish two laudable goals at once—deficit reduction and a more attractive student loan program. A partial list of the important benefits that could be derived from this bill would include more favorable borrowing terms and conditions for students; a program that is simpler and more comprehensible to borrowers and their families; and a stronger role for higher education in shaping future loan policies to benefit students, unfiltered by the existing array of intermediary organizations. We believe the proposed program is better than any alternative we have seen, and feel that it merits your support.

Senator WELLSTONE. Thank you, Mr. Atwell.

Mr. Cheever.

Mr. CHEEVER. Thank you, Mr. Chairman. I will summarize my remarks in 2 minutes and ask that they be included in the record, please.

Senator WELLSTONE. Without objection, they will be included in the record.

Mr. CHEEVER. Mr. Chairman and members of the committee, my name is Dan Cheever. I am chairman of the Coalition for Student Loan Reform and president of American Student Assistance, the Massachusetts organization which was the model for the Federal loan program. And here is the "bottle opener" for the beer can the economist is looking for—the proposal which deputy secretary

Kunin this morning asked for, an alternative to the present loan program and also to direct lending.

As a former superintendent of schools and college present for 20 years, I am not here to argue against the wisdom of testing direct lending, nor will we suggest that the existing loan program should be preserved.

To the contrary, and thanks to the leadership of many members of this committee, there is a clear consensus that Federal student loan programs require significant change.

Understanding they must be overhauled, we believe Congress and the administration have a chance to evaluate two new ideas. One is direct lending, and the other is a reformed and simplified Federal loan program, incorporating many of Mr. Witten's commission's recommendations, which preserves the present public-private partnership, saves $4.3 billion over 5 years, provides important benefits to students, and tests direct lending to see if it will in fact work.

We believe the evidence for moving cautiously on direct lending is substantial. As you know and have said, there are widespread reasonable budget saving disagreements by respected people. Those disagreements are supported by editorials in the Times, The Washington Post, the Cincinnati Inquirer, just this morning.

We share the concerns of many of the Government's own watchdog agencies, which have evaluated the Department of Education's management record in 10 separate reports since 1989 and found it sorely lacking.

The Department's new team and good intentions are admirable, but they do not yet constitute a good record.

Direct lending won't make college cheaper. That's the real long-term crisis. And the origination fees, which have been the subject of some discussion, I am glad were clarified by Senator Jeffords as going to the Department of Education, not to the private participants in the program.

What do we support? We believe that most of President Clinton's goals and those of many Members of Congress can be accomplished by reforming the current public-private partnership while also testing direct lending, as Senator Pell recommends.

We offer a bipartisan common ground for all who want change in the program, a proposal we think can unify, not divide, those who care about access to higher education.

Our proposal simplifies the current Federal loan programs by combining them into a single program for students and another for parents. It offers a variety of repayment options including income-contingent repayment. It accommodates national service. It reduces the number of loan defaults and the Federal cost of loan defaults. It offers substantial Federal budget savings over 5 years, underscoring estimates developed by CBO for Representative Gordon, whose bill is very similar to our proposal and which has been scored by CBO at $4.3 billion in savings. We respectfully urge the committee to consider the Gordon legislation. As you know, a majority of the House Budget Committee, 23 members, including Democrats and Republicans, have signed his statement of concern about direct lending.

This proposal is supported by the special task forces established by the Consumer Bankers' Association and by the National Council of Higher Education Loan Programs. We believe, and CBA and NCHELP agree, that we can deliver a better loan program and do it less expensively and more efficiently than at present and than under direct lending.

The statement contains five sections. The first focuses on why reform is needed. The second outlines our proposal and its savings. The third explains why we should test direct lending first—that is, the Department may not be able to administer direct lending, it may not save money, and we believe, most important, there are serious long-term risks to the economy. And I speak as a former college president—long-term risks to the economy under direct lending.

The fourth section examines the results of three nationwide polls we conducted, which reveal that both the American public and financial aid officers do not favor full implementation without a test.

And finally, we suggest in the last section additional concerns similar to Mr. Atwell's, and these include some specific concerns about the extraordinary powers in the House bill which are given to the Secretary of Education, which bypass negotiated rulemaking, threaten the security of private participants' assets—including, I would point out, their pension plans, which gets you into ERISA problems—and in general could harm the financial viability of the present program.

Mr. Chairman, I appreciate the chance to present our views.

[The prepared statement of Mr. Cheever follows:]

CSLR Coalition for Student Loan Reform

Statement of Daniel S. Cheever, Jr.
Chairman, Coalition For Student Loan Reform
President, American Student Assistance
Before the U.S. Senate Committee on Labor and Human Resources
United States Senate
May 26, 1993

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I. REAL REFORM IS NEEDED

As Chairman of the Coalition for Student Loan Reform, as well as a former school superintendent and college President for twenty years, I am not here today to argue against the wisdom of testing direct government lending. Nor will I suggest that the existing Federal Family Education Loan Programs (FFELP) should be held inviolate. Indeed, a clear consensus, both inside and outside the Coalition, is that federal student loan programs require change.

Understanding that the current federal loan programs will be overhauled, we believe Congress and the Administration have the opportunity to evaluate, over the next several years, two ideas for improving student loan financing. One is direct government lending. The other is contained in the Coalition for Student Loan Reform's proposal, entitled Reinventing The Federal Student Loan Programs, a proposal which would create a simpler and cheaper loan program. The current FFELP, as we know it today, should no longer continue.

The Coalition believes that the evidence for moving cautiously on direct lending is substantial. Wide disagreement exists about budget savings and the ability of the U.S. Department of Education to manage such a program. We understand that, even at this late date, the General Accounting Office (GAO) may revise downward its savings estimates attributed to implementation of direct lending.

The Coalition also shares the concerns of many of the government's own watchdog agencies which have evaluated the Department's administrative and management record and found it sorely lacking.

The Coalition also believes that most of President Clinton's goals and those of many Members of Congress can be accomplished by reforming the current public-private partnership while also testing the direct lending pilot program authorized only nine months ago. That is a key difference between the Coalition's reform proposal and the Administration's.

The Coalition's initiative offers more than a menu of cost savings to meet budget reconciliation targets. Its proposal dramatically simplifies the current array of federal loan programs, combining them into a single loan for students and a single loan for parents, as recommended by the Advisory Committee on Student Financial Assistance and the Commission on Responsibilities for Financing Postsecondary Education. Our proposal offers students a variety of loan repayment options, including loan repayment based on a student's income. It accommodates the President's National Service Initiative at whatever level Congress wishes to fund it. It reduces both the incidence of loan defaults and the federal cost of loan defaults by requiring the private sector to bear additional default risk and to pay a greater price when defaults occur.

It also saves billions of dollars, more than $4 billion over five years, under scoring estimates developed by the Coalition and by CBO for similar proposals under consideration by Members of Congress.

In return, the Coalition proposal asks for substantial reduction in government micromanagement. Participants in the current FFELP are burdened beyond imagination by layer upon layer of statutory and regulatory requirements, which add little to administrative performance but add a great deal to the cost of administering the federal loan program. The U.S. Department of Education has demonstrated neither the capacity nor the will to pursue outcome-oriented regulation of private program participants. Department regulators focus on process and procedure rather than results and performance.

Guarantors, secondary markets and lenders are fully prepared to make a public-private partnership work better for students and families. The Coalition's position is supported by them and by the Consumer Bankers Association (CBA) and the National Council of Higher Education Loan Programs (NCHELP). The Coalition believes, and CBA and NCHELP agree, that we all can deliver a loan program less expensively and more efficiently than is the case under the current FFELP.

Testing whether we can deliver, side-by-side with a direct lending pilot program, is a sensible way to make public policy.

We understand that although substantial disagreement exists about whether direct government lending either saves money or costs money, the FY94 Budget Resolution directs this committee to identify $4.26 billion in savings over five years from federal student loan programs. Before the Senate is forced to abandon a proper evaluation of direct lending through the demonstration program authorized less than a year ago, the Coalition requests that you consider its proposal which identifies comparable savings.

You now have a choice, an alternative way to reach the necessary budget goal, reform the student loan program, achieve virtually all of the Administration's goals, and heal a higher education community which is deeply divided over direct lending. Our proposal offers a common ground for all of us.

To develop this Coalition proposal we had to argue, listen, persuade and knock heads. It was hard work. Some guarantors are more financially sound than others in this program, and therefore can bear more default risks and cost sharing responsibilities. Differences among secondary markets and lenders, including portfolio size, may mean that the number of institutional players in the federal loan programs would shrink under the Coalition proposal.

But as Senator Simon has mentioned on numerous occasions, and he is correct, this program is not an assistance program for banks, for Sallie Mae, or for guarantors. It is a student assistance program.

As someone who has devoted his career to education, I believe the reforms we are proposing will benefit all students in our country. The Coalition proposal calls for a reformed, improved federal loan program for students. It reinvents a private-public partnership which can efficiently and effectively manage what will become a $25 billion per year education loan program by 1998.

Specifically, the Coalition proposal would:

1. Create a simple education loan program for students, families and schools. One loan program would replace the current variety of federal loan options. One loan application for students and one application for parents.

2. Vary the amount of interest subsidy within this single program according to need.

3. Create more repayment options for students, including income-contingent repayment plans, traditional repayment plans and national service forgiveness.

4. Reduce student loan defaults by improving student loan repayment options and shifting more of the cost of default from the federal government to the private sector.

5. Require Sallie Mae to share federal loan program costs substantially, by returning to the federal government a portion of the yield it earns on student loans it owns.

6. Reduce dramatically the federal subsidies paid to guarantors, all secondary markets and all lenders in the federal loan programs.

7. Eliminate many of the burdensome regulations that increase guarantor, lender and secondary market costs.

A more specific description of the Coalition proposal, including cost savings over five years associated with its provisions, is outlined in the next section. Later sections of this statement address specific concerns about the Administration's proposals and explain how the Coalition proposal represents a better idea.

II. THE COALITION PROPOSAL:
THE PROPOSAL AND ITS SAVINGS

The Coalition proposal includes:

I. **Maximum Simplification for Students and Maximum Cost Reduction Through Regulatory Reform**

- The Coalition for Student Loan Reform proposes a single, national federal student loan program and a single federal parent loan program to replace the existing, overlapping loan programs. One application process will make loan repayment easier and eliminate any defaults caused by student confusion over multiple loan programs with multiple terms and conditions. As proposed last month by the National Commission on Responsibilities for Financing Postsecondary Education, within this single simplified loan program students would receive varying levels of interest subsidy depending on financial need.

A. Simplification

- Standardization of all forms and procedures nationwide -- including applications, promissory notes, deferment forms (including the National Service Initiative) and uniform data exchange standards. The result will be better comprehension among students and their parents about the loan delivery and repayment process. The result for schools will be a more understandable and less burdensome loan processing mechanism to serve students.

- Elimination of the current requirement for a separate and distinct student loan application by allowing schools to access important individual student data supplied through the Free Application for Federal Student Aid.

- Allow guarantors to offer all schools electronic loan processing based on an approved electronic application software package compatible with the national student loan database still under development. This will ensure the student an even more rapid delivery of education loan funds. It will lead to the elimination of costly data input in the financial aid office and reduce the paperwork burden. Instantaneous tracking of student status, nationwide, also will help reduce defaults.

B. Regulatory Reform

- Financial participants in the current loan program face a regulatory environment badly in need of reform. Instead of performance-based and outcome-oriented regulation, loan program oversight has been implemented by the U.S. Department of Education under layers of Dear Colleague letters and private USDE letters.

- o Those regulations often do not reflect current law, forcing guarantors, lenders, secondary markets and postsecondary institutions to base financial and administrative judgements on interpretation of various Dear Colleague letters and, sometimes, guesswork.

- o The Coalition proposes a switch to simple, outcome-oriented regulation within federal student loan programs. Financial participants in the program are prepared to be held accountable to the highest standards of service to students and postsecondary institutions. The following section of this statement describes this regulatory reform in more detail and offers suggested legislative language.

2. **Improved Repayment Options**

- o Under the Coalition proposal, any student wishing to enter into income-contingent loan repayment may do so for an extended repayment period of up to 20 years. Options for traditional repayment, however, should continue to be available; most students want this option. In addition to providing relief to borrowers entering lower-paying careers, the Coalition believes this proposal offers substantial federal budgetary savings by significantly reducing loan defaults.

  Borrowers may elect to repay their loans on an income-contingent basis at any time during the life of the loan. The holder of the loan shall offer the borrower a range of income-contingent repayment schedules which provide the borrower with the ability to limit monthly obligations in the early years of repayment, as well as to extend periods of repayment up to 20 years. At any time during this extended period, the borrower may choose to shorten the time period, or pay off the loan entirely, as his/her income permits.

3. **Safety Net Against Defaults**

- o Defaults already are dropping ($3.2 billion in FY 1991 to $2.8 billion in FY 1992) because of previous reforms and the Coalition's reform proposal would reduce them further.

- o Our proposal lengthens the time during which a borrower can avoid default. Current policy allows only six months for a delinquent borrower to avoid formal default. Students facing default should be given more time, not less, to gain sufficient employment to meet their loan obligations and to respond to the default prevention activities of lenders and guarantors. Based on loan program data, a substantial percentage of current defaults could be avoided if students were offered nine months of delinquency, particularly if offered special assistance to avoid default during this time.

4. **Links Between Federal Student Loans and the National Service Initiative (NSI)**

- Today, lenders and guarantors process thousands of loan deferment forms. Current deferment processing costs are incurred by the loan holder/servicer at no cost to the government. NSI loan forgiveness could be accomplished in a comparable manner. Lenders would process post-college loan forgiveness as part of the NSI by developing simple procedures in cooperation with the Commission on National and Community Service and the U.S. Department of Education. As is currently true for deferments, a qualifying student's loan repayment responsibilities would be suspended during national service. Once community service is complete, a credit would be applied to the outstanding loan balance. Current student loan account reconciliation, conducted between lenders and the federal government, would be augmented to include NSI account reconciliation.

- The Coalition proposal also suggests using the existing student loan program infrastructure to carry the NSI forward at the local level. Lenders and guarantors already track student academic progress as part of the current loan program requirements. Every postsecondary institution that participates in federal aid programs in the country is integrated into the current loan delivery system. The relationships are processing-oriented and highly automated. NSI loan credit and loan forgiveness could become operational within the existing delivery system almost immediately.

5. **Reduce Lender Yield for Subsidized Loans from T-Bill + 3.1% to T-Bill + 2.5% During All In-School Period, Grace and Deferment Periods**

- Substantial reductions in interest subsidy expense are possible and can yield large savings to the federal government if the federal regulatory environment shifts to outcome- and performance-based Title IV regulations. These performance standards would replace the current layer of Dear Colleague letters, private Department of Education letters and costly, process-based oversight of agencies in the loan programs. Many schools, guarantors and lenders have created streamlined loan delivery arrangements, including electronic funds transfer and the use of escrow agents, which can significantly reduce lender cost of loan origination. These streamlined procedures, coupled with regulatory reform and adoption of the Coalition's standardization and simplification reforms described earlier in this statement, make reductions in participating lender yield possible and offer substantial savings.

- In addition, the cost of servicing a student loan during the in-school period is lower than when it is in repayment. The Coalition proposal recognizes such cost differentials.

6. **Recognize the Special Student Loan Program Cost-Sharing Responsibilities of the Student Loan Marketing Association (Sallie Mae), and Eliminate Guaranteed Minimum Yield to State Secondary Markets.**

A. Sallie Mae.

o Sallie Mae was created by Congress in 1972 to provide an adequate secondary market for federally guaranteed student loans. Without a healthy, national secondary market for education loans, it is likely that many private lenders would have curtailed their investment in the federal student loan program.

o Today, the national secondary market for student loans is larger and healthier than ever, with other secondary markets also meeting the liquidity needs of lenders. Sallie Mae has become the dominant financial player due to its low cost of funds and low processing costs resulting from its economy of scale.

o Sallie Mae's lower costs, attributable largely to its status as a government sponsored enterprise, would enable it to remain competitive even if its yield was reduced. This proposal recommends that an interest and special allowance offset of .50% be assessed on the principal balance outstanding of loans owned by Sallie Mae, to be collected quarterly from Sallie Mae.

B. State Secondary Markets.

o Currently, state secondary markets which originate or purchase loans with the proceeds of tax-exempt obligations are guaranteed a minimum yield of 9.5% on certain of their student loans, regardless of the rate of Special Allowance Payments (SAP) paid to other lenders. The Coalition's proposed amendment would eliminate this guaranteed minimum yield for tax-exempt loan holders, but only for loans financed by tax-exempt debt obligations issued beginning in federal fiscal year 1994 so as not to jeopardize outstanding tax-exempt financings. For all such loans, SAP would be set at 85% of the rate payable to all other loan holders.

7. **Increase Loan Default Risk-Sharing for Guarantors by Increasing Financial Penalties in the Event of a Default.**

o In spite of the current default "trigger" mechanism which reimburses guarantors at progressively lower levels (below 100%) if annual default rates rise above 5%, the total federal reimbursement rate for fiscal year 1992 was approximately 99%.

- The Coalition for Student Loan Reform believes the Administration and Congress should reduce guarantor claim reimbursements to 96% for guarantors with less than a 5% default rate; 86% *if their default rate is* greater than 5% and less than 9%; and 76% if their default rate is greater than 9%. Such an amendment will not only reduce federal loan program costs, it will provide a superior incentive to all guarantors to avert student loan defaults whenever possible.

- Secondly, the Coalition proposal recommends that guarantors be permitted to retain 27% of all loan default collections rather than the current 30%. This provision would increase remittances to the U.S. Department of Education on each defaulted loan collected, thereby reducing federal loan program costs. After considering fees paid to collection agencies by both the Department and guarantors and the internal administrative costs incurred by both, this change would maximize the amount which the Department would collect on defaulted loans.

8. **Additional Savings Recommended**

- Guarantor Administrative Cost Allowance, currently paid by the federal government at 1.0% of annual guarantee volume should be reduced to 0.5%. The reinsurance fee paid by guarantors, which is netted against the administrative cost allowance and which varies from 0.25% to 0.50%, should be eliminated. The net fee paid to guarantors will therefore be reduced to 0.5%.

- To further reduce the incidence of default and to preserve the integrity of the Parent (PLUS) loan program, PLUS loans should be subject to multiple disbursement and capped at $10,000.

9. **Direct Government Lending**

- Direct government lending should be tested in the pilot program authorized by Congress only 10 months ago to determine its actual costs, whether it places administrative burdens on schools and the U.S. Department of Education, its service requirements, and its impact on other executive branch agencies, including Treasury and the Internal Revenue Service.

- Later sections of this statement describe more fully the Coalition's reasons for endorsing the pilot program. In brief:

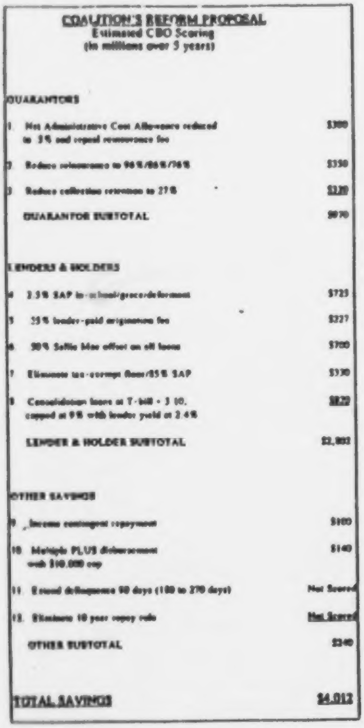
- The opposition of many colleges and universities to direct government lending on the basis of cost, service, and administrative burden calls for an evaluation period before dismantling the existing public/private partnership in favor of direct lending.

- o Recent studies by the Congressional Research Service (CRS), KPMG Peat Marwick, and Ernst and Young have called into serious question the CBO's and GAO's conclusions on potential cost savings of government lending.

- o The failure of the Department of Education to adequately oversee the existing loan program, as cited repeatedly by its own Inspector General and the GAO, also raises significant doubt about its ability to actually operate this new loan program.

- o Direct lending contains some long-term risks which could seriously harm higher education, risks which have received virtually no Congressional attention as yet but which will ignite a firestorm if any, or all, of them prove true.

The table on the following page summarizes these savings in the Coalition's reform proposal.



COALITION'S REFORM PROPOSAL
Estimated CBO Scoring
(in millions over 5 years)

GUARANTORS	
1. Net Administrative Cost Allowance reduced to .5% and repeal reinsurance fee	$300
2. Reduce reinsurance to 98%/88%/78%	$350
3. Reduce collection retention to 27%	$320
GUARANTOR SUBTOTAL	$970
LENDERS & HOLDERS	
4. 2.5% SAP in-school/grace/deferment	$725
5. .25% lender-paid origination fee	$227
6. 50% Sallie Mae offset on all loans	$700
7. Eliminate tax-exempt floor/85% SAP	$330
8. Consolidation loans at T-bill + 3.10, capped at 9% with lender yield at 2.4%	$820
LENDER & HOLDER SUBTOTAL	$2,802
OTHER SAVINGS	
9. Income contingent repayment	$100
10. Multiple PLUS disbursement with $10,000 cap	$140
11. Extend delinquency 90 days (180 to 270 days)	Not Scored
12. Eliminate 10 year repay rule	Not Scored
OTHER SUBTOTAL	$240
TOTAL SAVINGS	$4,012

II. THE COALITION PROPOSAL: REGULATORY RELIEF IS NECESSARY TO ACHIEVE THESE SAVINGS

The Coalition for Student Loan Reform's proposal offers potential federal savings through reductions in fees because the Coalition also proposes concurrent action by Congress to simplify the FFELP's administrative requirements and regulatory burdens. Financial aid officers and students will welcome this relief, as will other participants in the program.

Since 1980, Congress has passed numerous bills and budget reconciliation amendments which have made substantive changes in how student loans are administered. During the same period, as has been well documented, the Department of Education (ED) has done perhaps the worst job of any agency in developing regulations for these Congressional mandates. Section III of this statement summarizes this documentation of ED's poor management, as noted by several government watchdog agencies.

Regulations implementing the 1980 Reauthorization were not released by ED until after the Congress had passed the 1986 Reauthorization. History just repeated itself when the Department didn't issue the 1986 Regulations until two months after enactment of the Higher Education Amendments of 1992. These regulations are complex and, when overlayed on the complex provisions of the statute, create an increasingly impossible administrative task which burdens all participants, including students, and adds cost for the taxpayer.

For example, we know that an unemployed single parent with two children who has no money is not able to make a payment on his/her student loan whether the guarantor calls once or twice or month and whether it calls in the daytime or in the evening. But regulations require making these phone calls and sending letters anyway, regardless of the outcome.

We know that students just getting out of school often can take more than six months to find a job and thereby become able to make loan payments. But ED regulations require that a default claim be submitted immediately after six months of delinquency has passed, limiting a lender's and a guarantor's ability to work with a student borrower to avoid default.

The proposals which the Coalition has put forth would establish positive and appropriate incentives for performance to replace the punitive, often harsh regulatory provisions which now command exacting performance without results. A guaranty agency's willingness to absorb a substantial portion of default risk creates an enormous incentive for effective performance without additional process based regulatory requirements. Similarly, the Coalition's reductions in yield to lenders requires a commensurate reduction in the level of unnecessary, duplicative and senseless regulatory requirements which have driven up lenders' costs.

Thus, we recommend the following language be added to section 432 of the Higher Education Act to promote outcome-based regulation and to restrict the detailed procedural requirements which the Secretary may impose on agencies in the loan program. We also suggest that changes to regulation which do add requirements should apply only to loans originated after the effective date of those regulations, not retroactively to loans already made.

Amend section 432 of the Higher Education Act to add the following language:

> "The Secretary shall, through Negotiated Rulemaking, amend all existing Part B FFELP regulations and directives to simplify the administration of the programs for all participants, including students and post-secondary institutions, and to reduce the administrative costs incurred by lenders, schools and guaranty agencies. The regulations developed by the Secretary shall establish general rules for originating, servicing and collecting FFELP Part B loans which establish general standards consistent with sound and diligent banking practices, provided, however, that such regulations shall include outcome-based standards and shall not include absolute deadlines for performing such required activities nor shall they prescribe the specific manner in which such activities may be performed. The Secretary may not deny interest, special allowance or reinsurance on a loan unless the lender or guaranty agency failed to substantially comply with the requirements in a manner which materially affected the ability to collect the loan. Any regulations established by the Secretary which add or amend in a manner which adds to the administrative requirements to service a loan will apply only to loans which are made after the effective date of such regulation. Penalties associated with violations or omissions under the existing regulations are suspended until such time as the Secretary has published the regulations required under this section."

III. WHY DIRECT LENDING SHOULD BE TESTED FIRST:
DIRECT LENDING MAY NOT SAVE MONEY

The Administration supports the replacement of a guaranteed student loan program with direct government lending. It believes the shift to direct lending will save taxpayers money. The analyses performed by the General Accounting Office (GAO) and the Congressional Budget Office (CBO) also suggest there are budget savings from a shift to direct government lending, although their estimates of savings vary considerably.

However, direct lending also could result in a net loss over the first five years of the program. This conclusion has been reached in separate reports by the Congressional Research Service (CRS), by Dr. Rudolph G. Penner of KPMG Peat Marwick who is the former director of the Congressional Budget Office, in his study titled "Direct Government Lending vs. Guarantees for Student Loans: A Comparative

Analysis", and by Dr. Perry D. Quick, former senior staff member for the President's Council of Economic Advisors and current national director of tax and economic policy at Ernst & Young.

CRS concluded that "direct loans cannot be justified on the basis of either budget savings or increases in economic welfare". Dr.-Penner concludes "these analyses are severely flawed and the government may be on the verge of making a serious policy mistake."

Having studied the evidence on all sides, the Coalition believes that a switch to direct lending will not result in cost savings to the federal government and that assumptions used by GAO and CBO are inappropriate.

CBO may agree with the Coalition if, as reported, it currently is revising downward its direct lending savings.

The Coalition's conclusion is based on the following:

A. No True Differences in Economic Costs

There are no true differences in economic costs between a direct government loan and a guaranteed loan.

Direct government lending does make it easier to shift economic costs to the schools. But schools may be forced to absorb these administrative costs which may lead to higher tuition costs for students. If the federal government ends up bearing these costs, the alleged savings will be reduced drastically.

Dr. Penner's study also suggests other difficulties, such as the costs associated with indirect financing and interest rate fluctuations, which have not been included in either GAO or CBO cost estimates.

B. Administrative Costs Are Not Comparable

CBO assumes administrative costs of a direct lending program and the current program will be similar. This does not mean, however, that the costs are comparable. Budget accounting rules require that administrative costs of the current program be treated on a net present value basis. This means all the administrative costs to service the next five years of loan repayment are counted in current program costs. However, Congressional budget accounting rules require that the administrative costs of a direct lending program be treated on a cash basis. Therefore the costs are not counted until they are incurred. Since most of these costs are incurred during the repayment period, they lie beyond the Congress's five-year budget window. Thus, direct lending costs are underestimated and cannot realistically be compared to the current program.

C. Efficiency of the Delivery System

It is claimed that the delivery system under direct lending is a simpler approach for students. The public-private partnership of lenders, guarantee agencies, and secondary markets would be eliminated. However, these functions must still be performed under a direct lending program.

From past history, it seems unlikely that these functions will be performed more efficiently by the Department of Education. They may be performed more efficiently -- and all would hope they would be -- but more likely they will not. We should find out before plunging full-speed ahead into direct lending.

D. Administrative Burdens to Schools

Many of these government reports, including ED's own Inspector General, have expressed concern that schools will be unable to handle the additional tasks of loan origination under direct lending. Even supporters of direct lending have raised concerns about these burdens, which is real cause for worry.

CBO states "that direct lending would impose significantly greater administrative burdens and responsibilities on post-secondary institutions and the Department of Education. Many schools do not want these responsibilities and others are not capable of exercising them. The Department of Education, which has been criticized for poorly administering the current guaranteed loan programs, may not be capable of assuming the additional managerial responsibilities associated with a direct government loan program. A mismanaged direct government loan program could foster more fraud, waste, and abuse."

The study conducted by KPMG Peat Marwick points out the Department of Education will have responsibility for phasing out the current program. These costs are not factored into the GAO figures.

E. Impact on Default Rates

CBO and GAO cost estimates also assume that default rates will be unaffected by the switch to direct lending. It is difficult to believe that removing the current system will have no impact on default rates. As history shows, the Federal Insured Student Loan ("FISL") Program and the Perkins Loan Program have much higher default rates than the current loan guarantee program.

F. Servicing Costs

GAO also assumes that servicing costs associated with a direct lending program will be comparable to Sallie Mae's. But an earlier GAO study revealed that industry-wide servicing costs were much higher than Sallie Mae's: this is likely to be true for direct lending, also.

G. Interest Rate Sensitivity

The GAO also relies on the assumption that the government ten-year borrowing rate is significantly less than the 91-day T Bill rate plus 3.10%. The GAO savings are based entirely on the assumption that interest rates will fall over the next five years. As Rudolph Penner concludes, "if interest rates remain constant--and past experience suggests that the assumption of constancy outperforms other types of interest rate forecasts--the government definitely loses by shifting to a direct lending program."

Considering these points, the Coalition believes the rapid implementation of a direct lending program to replace the current public-private partnership is a risky undertaking based on flawed assumptions about savings. Sensible public policy formulation would test the pilot program to establish which assumptions prove true.

III. WHY DIRECT LENDING SHOULD BE TESTED FIRST: DEPARTMENT OF EDUCATION MAY NOT BE ABLE TO ADMINISTER DIRECT LENDING

The debate surrounding the Administration's plan for restructuring the federal student loan program by means of direct lending has focused predominantly on cost savings. Absent from the discussion has been a thorough analysis of the U.S. Department of Education's administrative ability to absorb all functions currently performed by lenders and guarantors.

One cause of concern about direct government lending is fear that the Department will not be able to administer it, which is essential if the program is to work for students and schools. The Department's track record with the present program has left many wondering how ED will handle the additional responsibilities, authority and burdens placed on it by this new, untested and enormous program.

Below are some documented criticisms of the U.S. Department of Education's capabilities from the federal government's own watchdog agencies, issued in ten different reports in the last two years. It is especially noteworthy that no reports issued about the Department's capabilities have stated that ED can administer direct lending. At best, some have acknowledged that, with a large and costly infusion of additional resources, there is a possibility that ED could improve some of its deficiencies.

o **"An audit issued in September, 1989, disclosed that the Department's financial analysis certification procedures were not adequate to protect students or the interests of the Federal government. Institutions which do not meet the Department's regulatory criteria for financial responsibility participate in the student aid programs."** Statement of James B. Thomas, Jr., Inspector General, U.S. Department of Education, before the Permanent Subcommittee on Investigations, February 20, 1990

o **"The Department of Education has failed to ensure that program abuses are identified and prevented."** GAO, Stafford Student Loans: Millions of Dollars in Loans Awarded to Ineligible Borrowers, December, 1990, p.8.

o **"The Department is running a multibillion-dollar commercial-type loan operation with a data system that contains incomplete, inaccurate, unreliable information. It does not have accurate systems of internal control to ensure that federal assets are safeguarded against waste and loss. ... While the total impact of such abuses cannot be accurately determined because the data are so poor, we believe that a significant problem exists."** Ibid, p. 8.

o **"It is not an exaggeration to say that we have heard no testimony or seen any documents that suggest that the Department has done even an adequate job in managing and overseeing its student loan program responsibilities ..."** U.S. Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, Abuses in Federal Student Aid Programs, May 20, 1991, (Nunn report), pp. 27-28.

o **"Lastly, the Subcommittee found that through gross mismanagement, ineptitude, and neglect in carrying out its regulatory and oversight functions, the Department of Education has all but abdicated its responsibility to the students it is supposed to service and the taxpayers whose interests it is charged with protecting."** Ibid, p. 38.

o **"The Committee is also concerned with the ability of the Department of Education to administer the additional responsibilities of a direct loan program. It is quite evident that the Department has had a great deal of difficulty in properly administering the current loan program."** Report of the Committee on Labor and Human Resources, United States Senate, to accompany S. 1150: Reauthorizing the Higher Education Act of 1965, November 12, 1991. p.52.

o **"Both we and Education's Office of the Inspector General have identified substantial accountability problems related to Education's management of these programs. For example, in April 1991 we found Education's Student Loan Insurance Fund unauditable...In March, 1991 the Office of the Inspector General and the Office of Management and Budget completed a study that found**

Education's poor management practices contribute to high default rates, fraud, and abuse in the guaranteed student loan programs." GAO, Direct Loans Could Save Billions in First 5 Years With Proper Implementation, November 1992, p.2.

o "The majority of participants [financial aid and business officers in focus groups] expressed little or no confidence in Education's ability to manage a direct loan program. Specifically, these participants said that they do not believe Education can either efficiently distribute loan proceeds or effectively contract with private agencies for servicing and collecting loans...participants cited several problems, including burdensome regulations, unrealistic program goals, broken commitments, unanswered inquiries, unfair program audits, and misinformation." Ibid, p. 9.

o "Regardless of the [loan] program's structure, there are serious problems in the Department's financial and management systems. The Department lacks proper systems and controls to adequately manage its mutibillion-dollar student assistance programs, and problems erupting from these programs could eventually overwhelm any potential reform measures. For example, the Department's student loan information systems contain data that are not always useful, timely, or accurate, thereby limiting their use for compliance and evaluation purposes. As a result, millions of dollars have been loaned to borrowers for amounts exceeding statutory limits or to borrowers who are already in default and, therefore, ineligible for additional loans." GAO. Transition Series: Education Issues, December. 1992. p. 26.

o "We found that schools have mixed views about their ability to administer a direct loan program. But they share reservations concerning the Department's ability to manage the program." Ibid. p.29.

o "Poor management by the Department could trigger more loan defaults, for example, which would substantially erode potential cost savings." Ibid. p.29.

o "The Department of Education has had a history of mismanagement and poor oversight of the program's activities. It generally (1) has used ineffective procedures for determining which schools can participate, (2) has had inadequate financial and management information systems that contain inaccurate and incomplete data, (3) has conducted little oversight of the lenders and guaranty agencies, (4) has experienced high turnover in key management positions and has not hired staff with adequate skills, and (5) has had a management structure that inhibited program improvements. Not adequately addressing these problems could jeopardize the Department's implementation of the direct loan demonstration program." GAO, High-Risk Series:Guaranteed Student Loans, December, 1992, p. 24.

o "Both GAO and OMB have identified this program as one of the government's high-risk areas. ...OMB and the Department conducted a review that concluded that the Department's management practices contributed to high loan default rates, as well as fraud and abuse in the federal student aid programs." Ibid, p. 25.

- "... the Department has made slow progress in improving its information systems, and the National Student Loan Data System, authorized by the Higher Education Amendments of 1986, will not be implemented until, at best, December, 1993." Ibid, p. 27.

- "... the inventory of known problems in the Department's administration of guaranteed student loans raises questions about its ability to adequately manage a direct lending program." Ibid, p. 30.

- "Finally, Education's records had been inaccurate and incomplete, it had conducted little oversight of lenders and guarantee agencies, and it had inadequately trained and organized program staff." Statement of Charles A. Bowsher, Comptroller General of the United States, before the U.S. Senate Committee on Governmental Affairs, January 8, 1993.

- "The Department of Education, which has been criticized for poorly administering the current guaranteed loan programs, may not be capable of assuming the additional managerial responsibilities associated with a direct government loan program. A mismanaged direct government loan program could foster more fraud, waste, and abuse." CBO, Reducing the Deficit: Spending and Revenue Options, February, 1993, p. 270.

- "The Department did not have reliable and timely data on which to base its estimate of the future cost of outstanding guaranteed loans. GAO estimated that the cost could have exceeded $10 billion at September 30, 1991. Education developed its estimate of $6.1 billion using a model based on an analysis of data which were not reliable and on a number of other assumptions about the program and economy, some of which were not reasonable. Education also did not adequately document its methodology for estimating this cost. In addition, significant unreconciled differences existed between financial information recorded in the Department's general ledger, subsidiary systems, and Treasury reports." GAO, Financial Audit:Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement, March, 1993, pp. 3 & 4.

- "The Department assumed it would collect more than the guaranty agencies were previously collecting. However, a 1990 study comparing the Department's collection efforts to those of the guaranty agencies concluded that their collection performance is about equal." Ibid, pp. 30 & 31.

- "In its fiscal year 1992 FMFIA (Federal Management Financial Integrity Act) report, Education acknowledged that the general ledger could not be used to produce accurate and auditable financial statements." Ibid, p.30.

While the documentation listed above is more *general* in nature, a project-by-project analysis of the Department's capabilities also is rife with administrative shortcomings:

1. FISL

   - When the student loan program began, many states did not have guarantors so the federal government made direct student loans using private capital. The program was so poorly administered and inefficient that it was terminated by the Secretary in favor of the public-private partnership we have now.

2. The Clinton Transition Education Task Force findings only five months ago (presented by its chair at a panel discussion, Lesley College, March 3, 1993) included the Department's:
   - Inability to analyze and/or retrieve information. Team members never received most of the reports or documents they requested from DOE upon their arrival. DOE was not able to provide an accurate figure of the Pell Grant shortfall. The Department had done little, if any, evaluation of existing programs or reliable accounting of funds spent. The small amount of modeling and forecasting that had been done was so inaccurate as to be useless.

   - Lack of technology. No mainframe computer exists for the entire Department. Instead there are three mainframe computers, (one runs on punchcards) located in different parts of the country. Many employees have no computer access at all, and rent PC's from retailers for special projects. What technology is accessible is often outdated Ataris and Apples. Only one technology expert was chosen for the Transition Task Force, and this problem received little attention in the group's final report, leaving members pessimistic about improvement in this area.

3. The Infamous '86 Reauthorization Regulations Package

   - Final regulations for the Higher Education Amendments of 1986 were not published until the fall of 1992, after the 1992 Amendments had already become effective. During the six-year interim (1986-1992), program participants were liable for implementation but received no binding guidance from the Department.

   - Soon after the final regulations were published for the 1986 Amendments, Secretary Riley issued a "hold harmless" letter, which requires student loan system participants make "good faith efforts" to implement regulations but releases them from liabilities resulting from those actions. This was necessary due to the high number of technical errors as well as issues needing clarification and issues and implementation dates requiring reconsideration contained in the final regulations. A Dear Colleague letter (non-binding guidance) is not expected until late this summer.

4. *National Student Loan Data Base*

   - o Suggested by Congress in 1985 Higher Education Amendments. No significant movement toward development taken by Education.

   - o Included in 1986 Amendments. Targeted for completion by December. 1993.

   - o Contractor for development not chosen by ED until early 1993. December, 1993 completion date is unrealistic.

   - o Failure to develop NSLDB blamed for high incidence of loans made in excess of program limits and to defaulted borrowers.

5. Common Application

   - o Mandated in 1992 Higher Education Amendments. Full implementation required by December 31, 1993.

   - o Guarantor community designed Common Application and submitted to ED for approval in the fall of 1992. This allowed lead time for printing and technology upgrades for timely implementation as required by law.

   - o ED did not issue approval until mid-April. 1993. In early May. ED rescinded its approval of the form. It is still on hold.

6. Direct Lending NPRM

   - o During the time that ED was trying to write the Direct Loan Demonstration Program NPRM for an April 1. 1993 deadline. schools and lenders complained to guarantors that ED had stopped issuing guidance on the present program.

7. School Oversight

   - o Cohort Default Rates
     - ED has been successfully sued by a number of schools over faulty cohort default rates that made their students ineligible for aid.
     - ED has not been meeting deadlines for schools' default rate appeals. Guarantors are obligated to continue making loans available to high-risk schools' students while appeals are pending.

   - o Last year the Department issued a list of school codes to guarantors. intended to notify them of all schools with valid Participation Agreements on file, consolidate multiple codes for the same institution. etc. ED's list contained so many errors that it had to be recalled. ED had confused different schools with similar names. left out proprietary schools and listed outdated codes. As a new list has never been issued. guarantors were forced to request new copies of Participation Agreements from each school with which they do business. (Some guarantors deal with thousands of schools.)

- o Schools are required to send their financial statements to ED, but ED only notes their receipt. ED does not read or analyze the information contained in the statements.

- o Lack of Department oversight allowed many proprietary trade schools to fraudulently obtain or abuse Federal student loan money by using aggressive recruiting techniques to lure students to attend these schools. About three times as many students attending such schools default on their loans as students from community colleges. Source: National Journal Government Executive, November, 1991, Darman's Radius.

- o The Nunn report said many of the schools were more interested in collecting financial aid checks than in education and called the oversight of the schools by the Federal Department of Education "dismal." Source: New York Times, July 15, 1991, In Ruling, Hope for Students Deceived by Schools.

8. Forecasting

- o The Department of Education has consistently underestimated Pell eligibility, resulting in $2 billion program deficit.

- o ED never predicted that defaults would rise when proprietary schools were allowed in the loan program; 75 percent of all defaults are from students who attended proprietary schools.

9. Mandatory Assignment

- o Presently it is taking ED a minimum of 3 to 4 months to process loans they have requested from guarantors under mandatory assignment. During the time period between the guarantor's submission of the file and ED's acceptance of it and entry on their computer, borrowers are not able to negotiate payment arrangements or dispute liability. Guarantors are prohibited from making payment arrangements after a file is submitted and ED has no means of tracking the file until it is entered on their system. Direct lending will involve a rapid increase of mandatory assignment of loans from guarantors during the transition period.

10. FAFSA (Free Application for Federal Student Aid)

- o ED failed to include school code listings on the 1993-94 FAFSA, leaving MDE's dependent on students' handwritten abbreviations of school names. As a result, financial aid offices are deluged with aid applications from students who have never applied to their schools, while applicants lose funding at the schools they want to attend because their financial information is delayed or not received at all. Some schools, such as the University of Michigan, have had to delay enrollment deadlines by almost a month, to accommodate the vast number of students receiving late awards.

- ED's mishandling of the MDE contract awards in 1992 has caused the nation's largest MDE to request termination of its contract with ED. As a result, services to students and schools are likely to be disrupted.

11. Income Contingent Loans

- In the late 1980's, the federal government tested Income Contingent Loans with a pilot of ten colleges and universities. The program was shortly discontinued because it was an "administrative nightmare" to collect income information and the program was more expensive than anticipated. (New York Times, November 25, 1993)

12. IRS Collections

- ED erroneously sent the IRS the 1991 default list for several states. Borrowers on this error-filled list were denied IRS refunds, even though many had paid their loans in full and had never defaulted.

Given the record of the Department of Education, as summarized above, any assertion that ED can manage direct lending is, in Churchill's phrase, the triumph of hope over experience.

III. WHY DIRECT LENDING SHOULD BE TESTED FIRST:
THERE ARE LONG TERM RISKS IN DIRECT LENDING

In addition to short-term concerns about cost and ED's management ability, proposals for full-implementation of direct lending carry potential long-term risks to both higher education and the country. These risks have not been adequately assessed in the hurried political debate accompanying the announcement of these proposals and their one-day consideration by the House Committee on Education and Labor. Years from now, the Coalition for Student Loan Reform fears that policy-makers on Capitol Hill as well as college presidents, financial aid officers and -- most important -- students, parents and taxpayers may ask hard questions about why we did not address these potential long-term risks during 1993's consideration of direct lending.

RISK #1: Are We Building Partnerships or Bureaucracy?

During the campaign President Clinton spoke of reinventing government, a powerful notion based, in part, on the writings of David Osborn. Central to this notion is the belief that some functions are best designated to federal, state or local government while others are best carried out by private partners who work in close collaboration with government under authorizing legislation. There has been a long history of such public-private partnerships in American government, and the concept of reinventing government recognizes their important contribution.

President Clinton is applying this concept of public-private partnership as the key element in his most prominent legislative initiative, namely health care reform. The Health Care Task Force reportedly has rejected a model in which the federal government would develop and offer universal heath care insurance as a program administered directly by the federal government. The Task Force rejected such a model, exemplified in the Canadian system, in favor of a public-private partnership that would promote "managed competition" among existing providers under rules established by government. The Clinton Administration contends that such a health care public-private partnership, operating under new legislation, and rules, would offer greater benefit and savings to the American public than a large government-funded, government-run program.

And yet the Administration proposes to dismantle a successful public-private partnership in student loan funding. This partnership has provided access to higher education for over 50 million students during the last 30 years. Rather than seeking dramatic reform within the current public-private partnership, reform that would be consistent with the Administration's other goals of program simplification, income contingent repayment and national service, the Administration's direct lending proposal would rely upon a federal bureaucracy to manage one of the government's largest financial aid programs That same bureaucracy would regulate itself.

Colleges and universities dissatisfied with this centralized federal management of the federal loan program will have no alternative source of loan capital, as they now have when a particular lender fails to offer students adequate capital or services. They will have no alternative loan servicers or other participants in the program, as they now have when a loan servicer fails to meet its required obligations, because the Administration's proposal gives the Secretary of Education, not colleges, authority to select the private participants in the program.

The Coalition for Student Loan Reform believes it is inconsistent with the President's own philosophy to create a new public-private partnership in health care while replacing such a partnership in student loans with a new federal bureaucracy.

RISK #2: Direct Loans Prove Less Efficient, More Costly Than Federal Guarantees

There is a long federal tradition of providing federal guarantees for loans made with private capital when such loans achieve an important national purpose. For many years, the federal government has guaranteed private loans to small businesses, American farmers, minority enterprises, low-income home buyers and even foreign governments.

The use of a federal guarantee has accomplished important national purposes without the requirement of federal funding for the capital requirements of those programs. To be sure, this guarantee approach has required a supporting structure of organizations, largely non-profit, which act as agents of the federal government to insure that federal regulations are met and federal purposes are fulfilled. To the Coalition's knowledge, there has been virtually no complaint about the complexity or cost of "middle men" in these federal guarantee programs, and their cost and complexity are no greater than those associated with the current Federal Family Education Loan Program. If "the middle men" is an issue in the federal loan program, then it must also be an issue in agriculture, business, housing, and minority affairs.

As described earlier in this statement, the evidence that direct lending will prove cheaper is controversial and unproved. Given the controversial, unproven nature of any direct lending savings, combined with the widespread use of federal guarantees for other national purposes, it is a risky roll-of-the-dice to scrap a long-standing guarantee program.

RISK #3: Who Pays the Piper, Calls the Tune

The old adage "he/she who pays the piper, calls the tune" has much truth in it. Under the Administration's proposal, direct lending will be managed and administered entirely by the Department of Education. It will continue as an entitlement program funded, the Administration hopes, by taxpayer purchase of federal debt. Student loan obligations are estimated to be $15 billion this year, rising to $25 billion in three years and totalling $60 billion over the next five years.

How much money will direct lending need in the future? College costs have been rising at 8 percent annually for 20 years according to the College Board, which is twice the rate of inflation and more than twice the growth in after-tax family income. Representative Pat Schroder's Select Committee on Children Youth and Families documented tuition increases of 141 percent during the 1980's alone. This bad news will get worse.
Student enrollments are now rising in elementary schools. Therefore in the not-too-distant future, more and more students will be enrolling in colleges and they will need to borrow more and more money to pay rising tuitions. This year's annual student loan funding requirement of $15 billion will rise to $40 billion annually, then $50 billion and, someday, $100 billion annually. In fact, such increases are predictable, given the importance of post-secondary education to the American economy and to the career prospects of individual Americans.

When student loan funding requirements have risen to these levels, the cost of issuing so much debt will add pressure to the interest rate the Treasury must offer, and the additional interest on this increased federal debt will create even greater pressure on the federal deficit. The Coalition for Student Loan Reform fears that direct lending will become another health care time bomb.

Our nation learned the lesson the hard way with Medicare. Its passage a generation ago fueled the explosion in the cost of health care. That explosion, in turn, led government to impose spending caps and regulations on hospitals and other health care providers because government was paying the bill -- more than $200 billion annually, or 13 percent of all federal spending and projected to hit 23 percent in only seven years. Federal spending caps, federal regulation and federal intrusion into medical practice has harmed medicine -- ask any doctor, hospital, teaching hospital or medical school. And it has not controlled medical costs nor provided universal health care.

A few years hence, federal alarm over the high cost of funding Treasury borrowing to sustain direct lending's enormous requirements, and the accompanying effect on interest rates of servicing this additional federal debt, could lead to federal intrusion into higher education.

What might that intrusion look like? If Medicare offers a reasonable comparison, and it does, then higher education can expect federal inquiry -- or regulation -- about faculty teaching loads, faculty productivity, class size, course offerings, indirect cost reimbursement, the duplication of services among institutions located within the same geographic area, and salary and compensation requirements. Medicine has faced each of these intrusions. Above all, higher education will face enormous federal reporting and paperwork requirements, as health care does now. These federal actions will do significant damage to higher education.

RISK #4: Direct Lending May Threaten Higher Education Independence

The American system of higher education is the envy of the world. A higher percentage of American citizens attend post-secondary institutions than citizens of any other country. More than 400,000 foreign students enroll annually in American institutions, a testimony to the strength of American higher education. Yet within the 8,000 different post-secondary educational institutions in this country there is enormous variety and diversity. Many are great research universities enrolling tens of thousands of students at undergraduate, graduate and post-graduate levels. Others enroll a few hundred students but perform, nonetheless, a unique and important function. Most are publicly supported institutions, but many are private and date from the earliest years of our country's history. Some are proprietary, most are non-profit. Not all are perfect but, as a system, the variety and diversity of American higher education is the envy of the world.

The federal government performs many functions admirably, but sustaining and nurturing such variety among different types of educational institutions is not one of them. To the contrary, legislation, regulation, audit reviews and other actions by the federal government impose uniformity and consistency among non-governmental enterprises more than they nurture variety, independence and difference.

Thus, the potential for significant damage to the historic independence and variety of higher education is very real. When more and more students are dependent on the federal direct lending program for more and more dollars, government inevitably will want to raise questions about controlling the tuition increases which fuel the need to borrow, as has happened in health care. It will do so by raising the kinds of issues which have hobbled health care. That action will have a chilling effect on the independence of diversity of higher education and, therefore, the American economy and society.

RISK #5: Defaults May Rise Under Direct Lending

Proponents of full implementation of direct lending argue that it will allow defaults to fall. They believe the Department of Education will do a better job than lenders or guarantors in managing the program to reduce defaults and, further, that the possibility of IRS collection (which is only to be studied) will be an effective tool.

Much of the cause of rising student loan defaults during the late 1980's was attributable to poor Department of Education management of the program, as documented by several GAO and IG reports mentioned elsewhere in this statement. To be sure, some concern also was attributable to the shoddy oversight of lenders, guarantors, and other program participants. But it is neither logical nor historically accurate to assume that the Department's direct involvement will reduce defaults in the face of its record of the last decade.

In fact, student loan defaults already have begun to drop significantly, from approximately $3.5 billion in FY91 to approximately $2.7 billion in FY92. Reforms contained in last summer's reauthorization of the Higher Education Act are expected to further reduce defaults.

If the Department of Education were likely to be more effective in controlling defaults under direct lending than the current public-private partners, then why would the Career College Association (CCA) be such an early and avid supporter of direct lending? Proprietary schools are responsible for 75 percent of all student defaults. It is quite possible that direct lending managed solely by the U.S. Department of Education will prove, as some fear, to be a blank check for those proprietary schools which have taken advantage of federal loan programs in the past or committed outright fraud. An entitlement program with unlimited sources of treasury debt to fund its tuitions, the direct lending program will be an attractive target to those institutions -- proprietary or otherwise -- which have failed students in the past.

IV. WHAT THE PUBLIC AND FINANCIAL AID OFFICERS WANT:

NATIONAL POLL RESULTS --

AMERICANS OPPOSED TO DIRECT LENDING

The American people are very skeptical about direct lending. Members of the Coalition for Student Loan Reform have taken three different surveys to gauge national attitudes on the issue of direct lending. Each survey reports similar results.

These polls reveal the public is not very aware of the issue. They haven't thought much about it. But when they do think about it, they do not have faith in our government's ability to run the program. They do not think direct lending will lower costs and lead to better service.

The most recent survey was conducted May 8-10 by Penn & Schoen. They questioned 1,003 adults nationwide and the survey has a margin of error of plus or minus 3.1 percent.

The first question asked was whether those polled had heard about any proposed changes in the federal student loan program. Half responded no. Of those who said they had heard something, nine percent knew President Clinton is proposing something, but they did not know what it is. Only five percent mentioned a new program run by the federal government.

When told that the federal government now "makes loans accessible through state loan agencies and commercial lenders. . ." and asked if they favor or oppose the current system, **the overwhelming majority (74 percent) said they favor the current system, while only twenty percent said they oppose it. Of those who have ever had a student loan, 81 percent expressed approval of the current program.** We believe this tells us that, overall, the public supports the current public-private partnership.

Despite the overwhelming support expressed for the current system, when asked whether the management of the loan program should be shifted "from local banks and private lending institutions to a federal government agency," the public was evenly split. But only 18 percent strongly favored that move, while 26 percent were strongly opposed.

The most telling responses, however, came when poll-takers explored what the public thought about the likely impact of shifting loan management directly to the federal government. Then their vague or mixed feelings turned to real worry. What impact would it have on the cost of the program? **Sixty-four percent said federal management would increase the cost, while only 14 percent said it would lower the cost.** Would it mean more bureaucracy or less? **By a 68-8 percent margin they said it would mean more bureaucracy.** And would it make it harder or easier for students to get loans? **Forty-four percent said harder, while only 28 percent said easier.**

These findings tell us that, when the public thinks about it, they have very little faith that direct lending will be a better system. They think it will be a more costly and bureaucratic system which will make it harder for students to get the loans they need.

Many members of this Committee will be pleased to know that the public loves national service. By a margin of 86-12, they favor the creation of a national service program.

The second poll was conducted between April 23 and May 2, 1993 by Hamilton & Staff. This poll surveyed 17 to 24 year-olds (college-age young people) and their families. The sample size was 600 with a margin of error of plus or minus four percent.

The survey explored their attitudes in a variety of ways, but when asked "Who do you think would do a better job running the student loan program?" **74 percent said "a partnership between the federal government, guaranty agencies, and banks," while only 13 percent said "the federal government."**

Reasons cited for favoring the public-private partnership over direct lending were based on doubts about the government's ability to manage another program. Their open-ended comments said they feel the federal government is already too large, doesn't do a good job managing financial programs, would not provide efficient service and would not save as much money as promised.

The Coalition does not want to imply that people are thrilled with the current system. They clearly want change, as does our Coalition. By a 56-36 percent margin they told us they oppose "leaving the current guarantee student loan program as it is today without changes." The Coalition agrees. And a similar proportion (54-38 percent) said they favor "designing a pilot program that allows comparison" of the current program with direct lending.

The third survey was conducted by Research Associates between April 26 and May 11, 1993. It consisted of 325 interviews with college presidents and financial aid directors at colleges and universities in all 50 states and the District of Columbia. It had a margin of error of plus or minus 6.9 percent.

Half of these higher education administrators favored maintaining the current student loan program while only 26 percent favored implementing direct lending. The main reason cited for this preference is that they believe direct lending will increase costs to students and decrease service to them, especially those students or institutions who need the most help. Three-fourths think the program will cost their institution money and students will ultimately bear the brunt of that cost.

The college administrators expressed serious apprehension about moving rapidly to direct lending. Nine of ten respondents, 89 percent, said there should be a trial period before deciding about full implementation of a direct loan program. The main reason cited for supporting a trial period was to see if the program works (66 percent).

The Coalition for Student Loan Reform believes these three separate national surveys should raise caution flags. The public, those most affected by changes in the student loan program, and those on the front lines on college campuses have serious reservations about direct lending. They have little faith that they -- as young adults, parents, taxpayers, or college administrators -- will be better served by making this dramatic, untested change.

IV. WHAT THE PUBLIC AND FINANCIAL AID OFFICERS WANT:

FINANCIAL AID OFFICERS ARE WORRIED ABOUT DIRECT LENDING

Proponents of direct government lending have attempted to argue that the only groups opposed to their view are self-interested industry types, the "special interests."

In reality, a groundswell of concern about direct government lending has emerged in the last few weeks. The voices of those expressing deep concern do not represent the interest of industry. Rather, these voices represent the interest of students, schools and taxpayers.

Chief among opponents to full direct lending without a test program is the National Association of Student Financial Aid Administrators, or NASFAA. NASFAA counts among its membership thousands of the nation's financial-aid officials--the men and women who are closest to students and who are most knowledgeable about how the financial aid process works.

As Congress may be aware, a resolution passed by the board of directors of NASFAA just last month calls for the direct government lending pilot to go forward because of NASFAA's concerns about full implementation of a high-stakes, untested direct loan program.

Those concerns are also reflected in resolutions passed by fifteen state and two regional associations of student financial aid administrators. **In addition, more than 428 officials of schools across the country--that the Coalition knows of; there are undoubtedly more--have written or signed letters expressing their personal concerns about direct government lending.** The opposition is persuasive, including 42 states and representing a cross-section of institutions, encompassing 137 state-operated institutions, and 203 independent institutions.

The Committee should find the range of their concerns particularly enlightening. The following is a summary and some of the highlights of what we have received:

Total Letters/Signatures from the Financial Aid Community

428 from Schools
16 from State Associations of Student Financial Aid Administrators
2 from Regional Associations of Student Financial Aid Administrators
1 from the National Association of Student Financial Aid Administrators (NASFAA)
3 from Miscellaneous Higher Education Associations
9 from State Higher Education Governing Bodies
4 from State Government Officials

Total Signatures from Schools by Type of School

Community/Junior Colleges:	61	14%
Independent Institutions:	202	48%
State Institutions:	136	32%
Vocational Institutions:	27	6%

Physical Letters from Schools: 129

Direct lending letters from schools represent 42 states.

Here are just a few highlights:

- A letter issued by the Oklahoma State Regents for Higher Education and signed by 26 presidents of institutions in that state warns, "Full-blown implementation of a direct lending program (in lieu of a pilot program) could end up increasing costs to the federal government and institutions of higher education." The letter calls for efforts to reform and generate savings in the current program, exactly what the Coalition for Student Loan Reform has proposed.

- A group of presidents from 22 Midwestern independent colleges and universities raises another issue:

  > "A direct lending program which purportedly saves money for federal budget purposes may increase the price of college to its intended beneficiary, the student."

In sum, the concerns of schools boil down to the following issues:

- The vast majority of schools believe that a pilot program is a prerequisite for direct government lending. As Benny Walker, vice president for enrollment at Furman University has written to Secretary Riley (a Furman graduate), "A small test pilot would let us find out if the savings potential and administrative capability are really here. With a multi-billion (dollar) loan program as the centerpiece for access to higher education, we can ill-afford to hastily make a change that has the potential of stalling the higher education pipeline."

- Direct lending poses administrative challenges, costs and risks that numerous schools feel they cannot bear.

- Schools worry about the liability they may face as loan originators.

- Schools doubt the cost-savings figures that have fueled the direct lending momentum, and many express their concern that taxpayers will wind up carrying 100 percent of the risk for a huge government spending program.

- Others worry that, pronouncements by Secretary Riley notwithstanding, a federally-funded loan program will eventually be rationed, following in the footsteps of Pell Grants which are chronically underfunded.

- Schools simply do not believe a federal bureaucracy will serve students better than the private sector. A chorus of concern focused on the Department of Education's well-documented deficiencies in managing the current program, as described earlier in this statement. Schools are currently trying to contend with massive problems caused by delays in approval of the common application form, and the Department's momentous problems with its new Electronic Data Exchange System.

- Expressing concerns over the barrage of regulatory and legislative changes that have already beset schools this past year, some officials say the system cannot tolerate another major change so soon.

- A number of institutions point out that the present program works. Other officials point to the debacle created by the Federal Insured Student Loan Program (FISL), a direct government lending effort that proved unsuccessful, and warn against another such failure.

- Without the efforts of lenders and guarantors, some officials believe the national default rate will escalate under direct government lending.

The bottom line for most financial aid directors is adequately funding and service to students. If direct government lending fails, as many of these experienced aid officials fear, access for students may be severely jeopardized. These concerns, expressed in a letter by Tom Rutter, Director of Student Financial Services at the University of California - San Diego, attracted support from aid officers at more than 300 institutions who signed his letter. In part Rutter's letter said, "Many questions remain about the supply of capital, the impact on the federal debt, the level of service to students and institutions, and the possibility of increased default costs. ... Focusing on enhancing and streamlining the current Federal Family

Education Loan program would be of greater benefit to schools, and ultimately, to students."

John Bannister, Director of Financial Aid at the University of South Carolina, sums up the groundswell of concern best: "Because so many students depend upon these programs and there are too many unanswered questions, I believe that the stakes are simply too great to move quickly ahead with full implementation."

The Coalition for Student Loan Reform agrees. Its proposal calls for a reformed, improved and simplified loan program which also includes a test of the direct lending pilot. This proposal meets the concerns of financial aid officers while also giving direct lending advocates a fair chance to see if this alternative is, indeed, a better idea.

V. OTHER FLAWS IN THE ADMINISTRATION'S AND HOUSE COMMITTEE'S BILL

The Coalition for Student Loan Reform believes it very important to bring to this Committee's attention several aspects of the direct government lending legislation proposed by President Clinton on April 30 and slightly modified in the version introduced and approved by the House Education and Labor Committee on May 12 after only one-half day of consideration.

In particular, the House legislation is substantially different from the direct lending proposals originally presented by the Clinton Administration on March 5 upon which the Congressional Budget Office based its scoring of savings of $4.26 billion over 5 years.

We cite three examples of changes that appear to have cost implications which have not been scored at this time. They are:

1. Beginning July 1, 1997, the interest rate for student and parent loans will be calculated on the basis of a security of like maturity plus 1 percent for Stafford loans, plus 1.5 percent for Supplemental Loans for Students (SLS), and plus 2.1 percent for Parent Loans for Undergraduate Students (PLUS). [present interest rate caps for SLS/PLUS are maintained]

2. The loan fee paid by students will be reduced, effective once again in 1997, from a minimum of 5 percent to 3.65 percent.

3. An origination fee averaging $10 per borrower annually will be paid to the originating schools. Upon full implementation in 1997, this could very well amount to an annual expenditure of $50 million or more.

We note that the full brunt of these costs to the Federal Government will not be borne until 1997, the final year of CBO's present five-year scoring. This smacks of a budget gimmick. Once in effect, these costs will continue to accrue each and every year. In all fairness, CBO should make a full five-year projection of these costs.

The Coalition does not necessarily oppose these changes, especially the reductions in student interest rates and fees, but believes the Committee should be cognizant of the ramifications for the budget and for policy.

With regard to policy, the Coalition asks the Committee to consider the following:

Interest Rate Reduction

The Administration states the aforementioned change in how interest is calculated will reduce the interest rate to students by .5%. The House legislation, however, does not clearly define the security instrument upon which the new rate would be calculated, making this assertion difficult to prove and equally difficult to score.

Taking the Administration's statement at face value and extrapolating from interest rates in effect for the current program beginning July 1, 1993, students would pay under the new formula a rate of interest on Stafford loans of 5.6% (versus 6.1 % under current law) and 6.1% for SLS loans (versus 6.4% under current law). Parents, however, would be charged a rate of interest of 6.7%, exceeding the rate under current law (6.4%).

Congress is able to set the rate of interest as low as it wants, and it has the power to do so under the current program as well. A 5.6% rate of interest, and the current 6.1% rate for that matter, are very favorable rates of interest. At the same time, Congress is faced with severe underfunding of the Pell Grant and is considering cuts to the other campus-based aid programs. Herein lies the policy trade-off. The fundamental choice being made in offering slightly better terms and conditions on loans for all classes of students is a further depletion of grant funds for the lowest-income Americans.

Reduced Loan Fees for Students

Congress, again, is well within its rights to alter the loan fees it charges to students. The theory behind these fees is that they would go into a pool from which the Federal government would pay out defaults. Reducing this fee reduces the funds in this pool.

Direct lending, per se, will not reduce defaults. The overwhelming statistical evidence is that defaults that are not later cured are predominately the result of a student's inability to pay due to unemployment or under-employment. The introduction of income-contingent and graduated repayment options -- be it via direct loans or the current program -- is what will lead to lower defaults.

Many have speculated that the confusion surrounding implementation of direct lending will likely increase defaults. The Coalition reminds the Committee of its Report in 1976 which compared the default rate statistics of the Federally-Insured Student Loan Program (administered directly by the Federal Government) to programs run by state guaranty agencies (very similar to way the Federal Family Education loan Program operates now). We quote: [S. Rpt. 94-882, p. 4733]

> "Default rates are running much higher in the direct, federally insured part of the GSL program than they are in the state-run program."

Origination Fee to Schools

Proponents of direct lending cannot have it both ways. Does direct lending simplify the loan program for schools or does it impose additional administrative burdens, costs and liabilities as more than 400 schools attest in their written letters to Congress?

Actually, the origination fee as proposed will be inadequate reimbursement for the vast majority of schools. Dr. Rudolph G. Penner, whom we quoted earlier in this statement, reported estimates compiled by KMPG Peat Marwick that place the cost burden to be imposed on schools between $130 million and $179 million per year.

Schools all over the country are facing cutbacks in state support for higher education and tight administrative budgets on their own campuses. This token offer of $10 per student borrower is inconsequential. Direct government lending remains essentially an underfunded federal mandate. The very real fear of many campus administrators is that, over time, this token Federal support will disappear as direct loans turn out not to save money and Congress calls on schools to "share the sacrifice."

Broad Powers of the Secretary

One additional aspect of the Administration's proposal which the House Committee passed should concern all members of this Committee regarding the powers of the Secretary. As noted in the Conference Report which accompanies the Higher Education Amendments of 1992. [Conf. Rpt. 102-630, p. 42]

> "The Committee considers it unconscionable that a $12 billion program is operating on a series of 'Dear Colleague' letters, without final, published regulations."

Far worse than this, the Administration's legislation just passed by the House Committee delegates extremely broad powers to the Secretary, powers which will be challenged in court. Here are some of the more egregious examples:

1. The Department may publish in the Federal Register whatever standards, criteria and procedures the Department deems are reasonable and necessary to implement the first year of the Federal Direct Student Loan Program. At the same time, it relieves the Department of compliance with "Master Calendar" and "negotiated rulemaking."

   This takes away two very important controls which ensure that the Department is timely with its regulations and consults with schools and other parties likely to be most affected in its exercise of this very broad discretion. These controls have been important to members of Congress in past years.

2. The Department may award loan servicing contracts, through June 30, 1998, without regard to the procedures and requirements of the Federal government.

   Many of these procedures are intended to protect the taxpayer and ensure competitive pricing by contractors of the federal government. But the Coalition reminds the Committee of the prediction by the Congressional Research Service in its report of February 23:

   "Direct lending could increase budget outlays (federal debt) and reduce national income if it were unable to duplicate administrative cost efficiencies achieved by private lenders."

3. The legislation establishes very limited eligibility criteria for schools to participate in the first year of the direct loan program and then grants the Secretary broad discretionary authority to publish regulations governing approval of institutions thereafter.

School eligibility has been typically one of the issues that draws the most attention when Congress has considered making changes to the criteria in the past. To cede this authority to the Secretary with little guidance is not fair to schools who obviously have much at stake in the outcome of these regulations.

This is yet another argument for preserving the Federal Direct Loan Demonstration Program established last summer in order to test the concept first and also allow a sufficient implementation time to ensure an orderly transition.

Senator **WELLSTONE**. Thank you, Mr. Cheever.

Mr. Biklen, welcome. I apologize for mispronouncing your name when I introduced you. Please accept my apology.

Mr. **BIKLEN**. No problem. That is not the first time that has happened, believe me.

I appreciate the opportunity to be here, Mr. Chairman, and in the interest of time, I will summarize my remarks, assuming my written testimony is accepted in the record.

Senator **WELLSTONE**. Without objection, it will be included in the record.

Mr. **BIKLEN**. I think there are a number of issues with respect to how credit reform works; I think there are issues with respect to exactly what the savings are, and I think there are issues with respect to direct lending. But I would like to offer some specific recommendations which I think make sense in terms of where we are, which would achieve alternative savings, which I do not think would hurt the student, and as a matter of fact, I believe they would benefit the student, and would allow time to test the demonstration program. So let me go right to my specific recommendations.

First, I believe Congress should leave the current law unchanged to the extent that the demonstration program is left as is and tested.

Second, I think Congress should enact budget reconciliation measures to achieve the $4.3 billion savings target. I believe the Consumer Bankers' Association and NCHELP are in agreement with the package that would achieve that goal and would not have any derogatory effect on students.

In addition to changes aimed at reducing costs, however, I think that Congress should also enact a number of other changes to streamline the program and reduce costs to the student.

First, I would establish a single Federal Family Education Loan Program, with subsidized and unsubsidized components, and a single variable interest rate with standard terms and conditions.

Second, I would require that lenders, guarantors and secondary markets meet certain conditions if they are going to continue to participate in the program. For example, lenders would be required to allow borrowers to refinance all prior loans to the new variable-rate loan with the same terms and conditions; lenders would be required to offer electronic fund transfer; guarantors would be required to accept guarantees from agencies that find themselves in financial difficulty.

Third, I would integrate the new program's delivery into an enhanced Title IV delivery system which utilizes the free Federal application form as its application document.

And fourth, I would establish single-source borrowing so that a student would borrow from one lender, with one guarantor, and with one servicer; and unless the lender agreed to that, they could not participate in the program.

In addition to these proposals, I have a number of other proposals, and I would also note that while I am not representing the advisory committee today, I am a member of that committee, and they have also developed a number of proposals to streamline the current program.

I would now like to conclude and briefly review why I think Congress should adopt the reforms that I have outlined here, rather than enact full-blown direct loans and test the direct loan program first.

First, students will get lower interest rates through the refinancing mechanism I mentioned, and they will also benefit to the extent that the program is now streamlined. I believe that the number of participants in the program will be reduced, and that will also facilitate streamlining the program.

I think that many transition problems such as those associated with guarantor insolvency will be eliminated with this approach. And I think many of the arguments in favor of direct lending have focused on the front end delivery of funds. And I don't question that direct lending may result in simpler delivery of funds; however, I think that there has been a lack of focus on the back end when you get into the collection phase. I think that with a streamlined program, the current program, we could also deliver the funds better, but on the back end, I think there are real questions about the Department of Education's ability to administer it, and I think there are real issues in terms of this contracting. If we get into bidding for contracts, I think there are going to be real service issues, and I think you could run into a situation where, if a contract is not renewed, you have got to move the loans from one servicer to another, and that will create a whole new set of problems and confusion.

So in conclusion, I would urge you to adopt the reforms I have gone through because I think that they will allow time to test the direct lending approach to see if it works, and I also think that they will streamline the current program, provide the savings which will be more real and occur faster, and that this approach will benefit students.

Thank you very much.

[The prepared statement of Mr. Biklen follows:]

Prepared Statement of Stephen C. Biklen

Thank you very much, Mr. Chairman, for the opportunity to testify today on the subject of direct student loans. My name is Stephen C. Biklen and I am president and chief executive officer of the Student Loan Corporation, a public company that is 80 percent owned by Citicorp.

My testimony today is offered on behalf of the Student Loan Corporation and reflects my involvement in the Federal student loan program since 1980. I also believe my testimony reflects the views of other lenders in the student loan program, including those serving on the Education Funding Committee of the Consumer Bankers Association.

Today, I would like to focus on three issues involved in the current Congressional consideration of the direct lending issue:

1. How direct and guaranteed student loans are scored for budget purposes under the Credit Reform Act;
2. Current student loan industry efforts to develop alternatives to full implementation of direct loans;
3. How Congress should address direct lending, and why implementation of a package of reforms to the current program makes sense when compared with the full implementation of direct lending.

CREDIT REFORM ACT SCORING OF ALTERNATIVE STUDENT LOAN PROGRAMS

The Credit Reform Act, enacted in 1990 as part of an omnibus budget reconciliation bill, fundamentally changed the way Congress evaluates Federal costs associated with federally-funded student loan programs. The 1990 legislation corrected previous guaranteed prejudices in budget procedures. Unfortunately, in addressing past budget scoring deficiencies, new ones were inserted into the budget process, resulting in false projections of savings through replacement of the guaranteed student loan program with direct federally-funded loans.

One dramatic example of the problems with the Credit Reform Act is the scoring of the administrative costs associated with any student loan program. Under the current guaranteed student loan program, administrative costs are borne by lenders and guarantee agencies, which are compensated for performing this function through the subsidy paid to them. Under direct loans, administrative costs are not scored, because the cost of funds is borne directly by the Federal Government. This results in the appearance of lenders and guaranty agencies, subsidies costing much more than the cost of funds involved in direct loans. But, without considering the administrative costs involved in direct loans, a misleading impression of savings is created.

I am convinced that the Federal cost of administering a student loan program will be much higher in a direct loan program than in the current program. I believe that the current projections of administrative costs put forward by the General Accounting Office and the Congressional Budget Office are unrealistically low. Common sense suggests that administrative costs will be lower in a competitive environment, rather than under any structure of federally-awarded servicing or administrative contracts.

The concept of calculating the net present value of life of the loan costs on each year's cohort of loans also needs to be considered as Congress addresses the direct loan issue. The budgeting approach incorporated in the Credit Reform Act bears little relationship to the actual cash flows for any single budget year. Real savings can be achieved by reforming the guaranteed student loan program, rather than implementing direct loans. Therefore, alternatives to direct loans should be seriously considered in the current budget process. Put another way, the savings claimed for direct loans occur later than those claimed for reforms to the current program, and are also far less certain of ever occurring. Congress is being given the choice of either gambling that direct loans will be competently and efficiently implemented by the Department of Education, or supporting reforms that will achieve reductions in Federal costs with virtual certainty. The public policy choice is clear.

ALTERNATIVES TO DIRECT LOANS

This Committee is well aware that Congress enacted a direct loan demonstration program in 1992. We fail to understand why this program should be cast aside now in favor of full implementation of the direct lending program. What is it that justifies not waiting for the results of the demonstration program?

The student loan community has worked long and hard to achieve consensus on a package of savings proposals that achieve the reconciliation instruction of $4.265 billion in the student loan program. Among the savings proposals are reductions in the lender's special allowance and fees paid to guaranty agencies, as well as the payment of new fees by lenders to the Department.

I believe that these reforms will not result in disruptions in the availability of loans to students attending quality schools. Because of the significant reforms made in Department of Education and State oversight of schools, especially proprietary institutions, there are simply not large numbers of high default rate institutions remaining in the student loan program. Because the high default rate schools are no longer eligible for loans, lenders and secondary markets should be able to serve all categories of schools even though subsidies have been reduced.

SPECIFIC RECOMMENDATIONS FOR REFORM

I would now like to turn to specific recommendations for reform of the student loans program:

- First, Congress should leave current law unchanged so that the direct loan demonstration program can be implemented and evaluated according to the 1992 Reauthorization of the Higher Education Act;
- Congress should enact budget reconciliation measures to achieve the $4.3 billion savings directive required under the budget resolution. The Consumer Bankers Association and the National Council of Higher Education Loan Programs have recommended a package of savings designed to achieve this goal. I have attached a description of this proposal to my testimony.
- In addition to changes to the Act directed to reducing its costs, Congress should also enact additional changes to streamline the program and reduce student costs. These proposals should include the following:

- Establish a single federal family education loan program with subsidized and unsubsidized components and a single variable interest rate with standard terms and conditions;
- Require that lenders, guarantors, and secondary markets meet certain conditions in order to continue participation in the program. Lenders would be required to allow all borrowers to refinance prior loans to the terms and conditions of the new streamlined loan program in order to continue participation; and
- Integrate the new program's delivery into an enhanced Title IV delivery system which utilizes the free federal application for Federal student aid as its application document.

In addition to these three proposals, there are others which I would be happy to share with the Committee. Many of these proposals are being developed by the Advisory Committee on Student Financial Assistance, of which I am a member.

WHY CONGRESS SHOULD REFORM THE STUDENT LOAN PROGRAM RATHER THAN ENACT DIRECT LENDING

In conclusion, I would like to briefly review why Congress should adopt reforms to the FFELP program rather than enact direct loans:

- In addition to the immediate benefit of lower interest rates to students through refinancing, students will also benefit to the extent that the program is made less complex and easier to understand;
- The number of participants in the program will be substantially reduced. This will contribute to simplification. Those lenders remaining in the program will be those most committed to service to students and schools;
- Many transition problems, such as those associated with guarantor insolvency will be avoided;
- Most of the arguments in favor of direct lending have been over its alleged merits compared to the current program. While direct lending could simplify the delivery of funds, such improvement is dependent on the Department of Education administering the program competently. After reviewing the legislation proposed by the administration, many schools believe the direct loan origination process will be more complex and expensive than the current system.
- Most important, it is inconceivable that the quality of service available to students during the repayment period will be similar to that under the current program. If direct loans are to be serviced by private servicing and collection companies, these contracts will be awarded on a "lowest responsive bidder basis." I believe there will be a significant deterioration in the quality of servicing provided to both student-borrowers and schools. Problems will be compounded by the confusion created when a contract is not renewed with one servicer and loans are transferred to another servicer.

DIRECT GOVERNMENT LENDING IS A MISTAKE

Mr. Chairman, all of the available information—the unanswered questions on direct loans as well as the availability of an alternative package of savings to direct loans—suggest that Congress should proceed cautiously. The direct loan demonstration project should be evaluated before any further steps to replacing the current program are made.

As the Nation's largest originator of loans, the Student Loan Corporation is proud of the public-private partnership that is reflected in the current program. With reforms, there is no reason whatsoever to abandon this program.

Thank you again, Mr. Chairman, for the opportunity to be here today. I am pleased to answer any questions the Committee may have.

ATTACHMENT

1. Reduce administrative cost allowance to .5 percent for all guaranty agencies. This entails both a reduction in the current 1 percent reinsurance fee to .5 percent and repeal of the current .25/.50 percent reinsurance fees. The proposal assumes only new loans would be affected by this change and that all loan volume would be covered.
2. Modify guaranty agency reinsurance rates from the current 100 percent/90 percent/80 percent rates to 96 percent/86 percent/76 percent. The proposal assumes only new loans are affected. The current reinsurance triggers found in section 428(d) of the Act are not changed by the proposal.
3. Reduce guaranty agency retentions on collections from the current 30 percent to 27 percent. The proposal assumes both old and new loans are affected.

4. Reduce lender yield to Treasury bill plus 2.5 percent during in-school, grace and deferment periods from the current rate.

5. Impose a .25 percent lender-paid origination fee. The fee would be forwarded monthly to the Department of Education.

6. Impose a .5 percent offset on all outstanding Guaranteed Student Loans held by the Student Loan marketing Association. The offset would be paid monthly to the U.S. Department of Education.

7. Eliminate the current 9.5 percent floor on loans made with tax-exempt bonds. The proposal assumes both new and old loans would be affected. The special allowance on new loans would be 85 percent of the rate paid to holders of loans financed with taxable monies.

8. Reduce borrower interest rate on new Consolidation Loans to a rate based on T-bill plus 3.1 percent. The same interest rate formula is used on new Federal Stafford Loans. Interest would be capped at 9 percent. Lenders would pay a .7 percent rebate to the U.S. Department of Education. The rebate would be forwarded to the Federal Government on a monthly basis.

9. Require income-contingent repayment. The scoring of this proposal would be dependent on the specific legislative language. Such language will require sufficient levels of minimum payments so as to provide savings of $100 million.

10. Require multiple disbursement of all new PLUS Loans and cap annual borrowing per student under the program to $10,000.

11. Revise the definition of default from the current 180 days to 270 days. A change would affect all loans entering delinquency after October 1, 1993.

12. Repeal the 10-year repayment rule. Repeal of the 10-year repayment rule permits greater flexibility to be provided in the offering of income-sensitive or income-contingent repayment programs to borrowers.

13. Loan transfer fee of .25 percent. A loan transfer fee of .25 percent would be imposed on all loans sold or transferred to a new eligible holder.

Senator WELLSTONE. Thank you very much, Mr. Biklen.

Mr. Schullo.

Mr. SCHULLO. Thank you, Mr. Chairman.

I am very pleased to be here today and have the opportunity to discuss the Student Loan Reform Act of 1993.

I have been employed in financial aid for 27 years and have been at Bemidji State University, one of eight institutions in the Minnesota State University System.

Our enrollment is 5,400 students. We are located in north central Minnesota, within 40 miles of three major Indian reservations. Many of the students are high-need students from low-income families. Our cohort default rate on the Stafford loan is 7 percent, and our Perkins loan default rate is 3.94 percent. We administer $16 million in student aid, and $5 million of that is through the Federal Family Educational Loan Program.

My staff includes nine people. We have four professional staff members and five support staff members. We are a highly-automated office. We process applications automatically, they are packaged, and we transmit twice a week to four major guarantee loan agencies.

I am an advocate of direct lending primarily because of the need to simplify the student loan delivery and repayment process. I am also confident in saying that my administration at the campus will support me and back me in any resources I need to implement direct lending.

My financial aid career began in 1966, as a direct result of the Higher Education Act of 1965. So I have seen every amendment and reauthorization that has ever been passed in the area of financial aid, and in 1993, I find myself asking: Are they going to do the right thing this time? I certainly hope so.

I am getting tired of calls from the mother I call the "Mother on the Smoking Phone." You have probably received some calls from her as well. She has been calling me for about 27 years. That's why I stay around—hopefully, we will overcome some of these problems and smooth that out. I did happen to meet her once, incidentally. It was in Disney World, in one of those zig-zag lines. She was in front of me, and she turned and asked, "What do you do?"

I said, "I'm a financial aid officer."

And this is no exaggeration—she said, "I hate financial aid." And I had to ensure 20 minutes of financial aid bashing until we got up there. And that was on vacation. [Laughter.] So I would like her to stop calling me, and I sincerely hope that Congress will do the right thing and pass this Act.

I have been convinced for some time that doing the right thing will require a complete revamping of the Federal student loan program. We know how complex it is to determine eligibility and continually adjust loans for over-awards because of late scholarships or other outside funding. When we should be spending our time processing applications for financial aid and establishing awards for needy students, we find ourselves involved with other activities with lenders, guarantee agencies, receipting checks, returning checks, waiting for checks, or attempting to resolve the increasingly burdensome task of clearing students who have been determined to be in default because of a missing form or a computer glitch.

We know the cost to students in terms of confusion, delays and emotional stress. We know, too, that the more agencies involved between the funds and the students, the more confused students become, and the more problems they encounter. The process has become tremendously complex, involving many outside agencies. It is indeed time for a change.

We calculate at our institution that we would gain .75 of a position in the financial aid office and .30 of a position in the cashier's office by eliminating duties associated with the administration of the guaranteed student loan program. That would cover about 2,500 loans.

On the other hand, we estimate that it would take .75 of a position in the financial aid office to track promissory notes and .50 of a position in the accounting/disbursement office to handle the direct crediting of accounts, which is a computer process and pretty automatic, servicing accounts, drawing and reconciling funds. We estimate that the additional work load resulting from direct lending, when balanced against the reduced work loan resulting from the elimination of the guaranteed loan program, is almost a wash.

Many aid officers see direct lending as a shift of responsibility from the lender to the institution, and they are correct. This is exactly what it does—it cuts out the middleman and streamlines the process.

I share some of the concerns that were expressed by NASFAA and the student aid community, but I am yet to be convinced that a demonstration program would be any different than a phased-in program which is committed to the final goal of a successful direct lending program, because the phased-in program also contains opportunities for evaluation and improvement along the way. I think the commitment comes first. You listen to the students, and if you listen to them, you make the commitment. If you are committed to direct lending, then you follow the process to get you there.

I appreciate Senator Durenberger's comments, and he quoted some of my testimony which has been submitted, so I will not repeat that, but it gives me an opportunity to tell you about an actual case of a student at Bemidji State University. I didn't plan to tell this, but it is a true story, and it kind of weighs heavy on my mind, so I am going to tell you.

On May 5th, I asked my receptionist to call in a student to see me. I was off to a conference and would be back on Monday. So when I walked in the door, I asked, "What time is Mark coming?" They said, "Didn't you see the morning paper?" I said, "No, I didn't." They said, "Well, he is not here. He was killed in a motorcycle accident."

Mark had a total of $30,000 in student loans. I had been working with him over the years, and he was just completing his master's program, and he would have been marching on Friday, day after tomorrow, in the commencement ceremony.

Mark was driving the wrong way on a 4-lane highway, dodging in and out of oncoming traffic, until he hit a truck head-on.

I cannot say for sure that the loans and the repayment and the problems and worries he had coming up on graduation were the cause of this. Alcohol was involved. But in talking to Mark, I know that he was extremely worried the last time I talked to him about going into repayment. He couldn't think of anything else but what would the payment be, and so we worked out some different scenarios, talked about consolidation. His ultimate goal was to go on to the University of Wisconsin at Madison and get his doctorate, but the loans worried him too much, $30,000, through the master's program. He was a single parent and supported a young boy. And he is not going to make that ceremony on Friday.

A great deal of opposition has surfaced, armed with all the facts and figures, to prove that this cannot be done. I hope in the process of making up the Student Loan Reform Act of 1993, you will remember the "Mother on the Smoking Phone," and perhaps Mark, and enact legislation which truly answers some of the frustrations of the consumers, the parents, and the students.

Thank you for considering my views. I'll be very happy to answer any questions you might have.

[The prepared statement of Mr. Schullo follows:]

PREPARED STATEMENT OF JOHN SCHULLO

Mr. Chairman and members of the Senate Committee on Labor and Human Resources, I am John Schullo and I am pleased to have the opportunity to appear before you today regarding the Student Loan Reform Act of 1993. I have been employed in the of Financial Aid Office at Bemidji State University for the past 27 years.

Bemidji State University is one of the eight institutions which make up the Minnesota State University System. Our enrollment is 5,400 students. We are located in north central Minnesota within 40 miles of three major Indian Reservations. Manly of our students are high need students from low income families. Our cohort default rate on the Stafford Loan program is 7 percent and our default rate on the Perkins Loan Program is 3.94 percent. We administer a $16 million student aid program of which over $5 million is in Federal Family Educational Loan Programs. My staff includes 9 full-time people . . . 4 professional staff and 5 support staff. We are a highly automated aid office. Loans are automatically packaged and transmitted twice a week to four major guarantee agencies.

I am an advocate of direct lending primarily because of the need to simplify the student loan delivery and repayment process. Despite some minor concerns about implementing any new student loan delivery system I am convinced that it can be done efficiently and effectively. I am also confident that I will be supported by my administration and provided with the resources necessary to do the job right. My confidence stems from knowing that this legislation is correct and that students are better served by programs with funds located at the institution and with fewer parties involved in the delivery process.

My financial aid career began in 1966 as a direct result of the Higher Education Act of 1965. I have, for many years, observed and eagerly anticipated each Amendment and Reauthorization of that complicated piece of legislation. In 1993 I find myself again asking, "Are they going to do the right thing this time?" I'm tired of receiving calls from the person I call the "Mother-on-the-Smoking-Phone." She has been calling me for 27 years. I would like her to stop calling me. I sincerely hope Congress will do the right thing and pass this act.

I have been convinced for some time that doing it right will require a complete revamping of the Federal student loan programs. We know how complex it is to determine eligibility and continually adjust loans for overawards because of late scholarships or other outside funding. When we should be spending our time processing applications for financial aid and establishing awards for needy students, we find ourselves involved with lenders and guarantee agencies, receipting checks, returning checks- waiting for checks and or in attempting to resolve the increasingly burdensome task of clearing students who have been determined to be in default because of a missing form or a computer glitch. We know the cost to students in terms of confusion, delays and emotional stress. We know too, that the more agencies involved between the funds and the student, the more confused students become and the more problems they encounter. The process has become tremendously complex involving outside agencies. It is indeed time for a change.

Toward doing it right, the direct student loan idea is not only right on target . . . it hits the bulls-eye. The proposed direct loan program simplifies the borrowing process for students and addresses default and repayment from the student's perspective and in a unique and realistic manner. The borrower would have a choice between a standard, extended, graduated or income contingent repayment plan.

I am committed to direct lending and favor the phase-in rather than a demonstration. The reason is that we already know one-half of the equation . . . the present Federal Guaranteed Student Loan system is too complicated and costly. There are too many players between the student and the funding and all of them are making a profit on the student. We are dealing with a long-term evaluation process. It is impossible to evaluate direct lending without considering the repayment results and if we wait for an evaluation of the repayment of a demonstration program, we will have to postpone the implementation of direct lending for years at a tremendous cost to students.

We calculate that we would gain .75 of a position in the Financial Aid Office and .30 of a position in the Cashier's Office by eliminating duties associated with the administration of guaranteed student loans. On the other hand, we estimate that it would take .75 of a position in the Financial Aid Office to track promissory notes and .50 of a position in the accounting disbursement area to handle the direct crediting of accounts, servicing accounts, drawing and reconciling funds. We estimate that the additional workload resulting from direct lending when balanced against the reduced workload resulting from the elimination of the guaranteed loan programs is almost a wash. Many aid officers see direct lending as a shift of responsibility from the lender to the institution and they are correct. This is exactly what direct lending does. It cuts out the middle man and streamlines the program.

I share some of the concerns expressed by NASFAA and the student aid community, but I am yet to be convinced that a demonstration program would be any different than a phased-in program which is committed to the final goal of a successful direct lending program because the phase-in also contains opportunities for evaluation and improvement along the way. I believe that direct lending will improve the delivery of loans to students and we should not hesitate in going forward with its implementation.

I want to mention three things about direct lending. They concern three very real frustrations people have with financial aid and how these frustrations are resolved by this direct loan proposal.

First, students feel caught in a government sting operation with regard to loans. They must take them to remain in school. No loan, no school. They know that the future is uncertain. For some, the odds are against their repaying their loans in a timely manner. The economy, the geographic region, the family history, crime rates, divorce rates, personality of the borrower, low wages of entry level positions . .

many factors enter into student loan default rates. Because of factors such as these, the current Guaranteed Student Loan programs guarantee defaults for a large segment of the borrowing population.

My point is that any loan program which uses as collateral the academic progress and potential earnings of the borrower, must either accept a high default rate on those loans or establish repayment options which address the default problem. The "Student Loan Reform Act of 1993" bill, just as the Durenberger-Simon IDEA loan bill before it, does just this.

To put it another way, some students have a choice . . . loan or no school. When they graduate or leave school, they have a choice . . . pay or default. When real life problems occur, including necessary consumer purchases such as groceries, clothing or an automobile to get to work, the choice often becomes one of survival or default.

The direct loan repayment plans provide exactly what students need . . . a less complicated method of borrowing money and a choice of reasonable repayment options. It seems to me that the government has no business loaning money out on the basis of potential earnings without either accepting a greater risk at the repayment end or providing repayment choices which help students through life's problems. In this regard, the direct loan proposal hits the bulls-eye, again.

Second, students are frustrated by the fact that someone is making a profit off of them. Students fall into a category of vulnerable citizens who need protection. They should not be a source of profit to anyone on their loans. Direct student loans would reduce the cost of administering loans and allow students to borrow the money they need at a reasonable interest rate. With direct lending, students are removed as a source of profit from the arena of commercial lending.

Third, students are frustrated with the complex and confusing repayment process. I believe that direct loans will save considerable dollars for students, institution (through timely disbursements) and the nation. This legislation would simplify and improve the management of student loans.

"The Student Loan Reform Act of 1993" is a positive consumer oriented act. It addresses all major student loan issues head on. The problems I hear from students and parents every day have been addressed in this proposed legislation. The ability to revise aid packages quickly and efficiently, student access to someone who is able to resolve problems on site, an institutional-based delivery system, unique repayment options, simplification of the process and elimination of profits are the major reasons I support the bill.

A great deal of opposition has surfaced, armed with all of the facts and figures to prove this cannot be done. I hope, in the process of marking-up the Student Loan Reform Act of 1993, that you will remember the "mother-on-the-smoking phone" and enact legislation which truly answers some of the frustrations of the consumer.

Thank you for considering my views. I would be very happy to answer any questions you might have.

Senator WELLSTONE. Thank you very much, Mr. Schullo.

Again, I appreciate the way in which you have taken the debate and the numbers and put a human dimension onto it.

What I want to do is we'll probably want to conclude this committee hearing at 2:15, if that is okay with Senator Kassebaum, since we have a vote coming up shortly thereafter, so we might just divide our remaining time equally.

I wanted to first put a question to you, Ms. Roemer, if I could. Chairman Kennedy recently received a letter from six past presidents of NASFAA who support direct lending, including two presidents who were heads of guarantee agencies. Can you explain why their positions differ from the one that you have enunciated as president-elect of NASFAA?

Ms. ROEMER. Well, I can tell you, as I said at the beginning, that there has never been an issue where we have seen more differences of opinion, and that basically is it. None of those six people who signed that letter are currently part of the board of directors of the National Association, and were not, from what I understand, present at any of the debates or discussions that went on as we wrestled with the concept of direct lending.

I will also note that I believe when I become chair—which is the new term for president—I will be the 28th NASFAA chair. That leaves 21 or so unaccounted for.

Senator **WELLSTONE**. Well, Senator Kennedy will have to speak for himself, but he might have figured that going back six presidents was enough recent history. It was actually a good faith question just to sort of find out, and I think I'd like to follow up just to find out what the different perspective might be.

Ms. **ROEMER**. There also is the difference that some of those are back longer than 6 years, if you look at the dates that they served.

It has really been a difficult decision for financial aid administrators. I am at an institution that is a community college; I do not participate in Perkins and have never participated in Perkins because it was $5 a credit hours when Perkins started, and we didn't think our students would ever need to finance postsecondary education with loans. And by the time we reached now the grand total of $232 full-time tuition and fees for registration, and some students actually do borrow money, there isn't Perkins loan capital for us to get involved in such a program.

So we have depended somewhat for some of our students' expenses on other loan programs. And I have seriously looked at the possibility of my institution going into direct lending. But if I had to focus on where I think the problems really occur with students, it is not so much the delivery of the loan check. And you have heard some stories from students who have had some problems in that area. But being a practicing aid administrator, for the most part, the checks come in on time. The problems are in the servicing of the loans.

The real area where students have concerns is the turnaround, the talking to the people, trying to get the information. As the assistant secretary said, she handled how many thousands of calls from people who had questions about their loans. How many of those are already now also answered by guarantee agencies, secondary markets, and other servicers? That is a tremendous change in terms of phone calls.

And I myself know that in just trying to get myself out of the SLS loan program a month ago, it took five telephone calls to one person who was identified in the Department of Education, and finally a personal letter to Bill Moran, to get someone to call me back.

Senator **WELLSTONE**. Given your response—and Mr. Cheever was sort of nodding his head—let me give you the opportunity to build on that, and let me just turn to Mr. Witten, Mr. Atwell, or Mr. Schullo, and have them respond as well, because I think we ought to just continue to close in on this central issue.

Mr. **CHEEVER**. I think it is a very key question, Mr. Chairman, and we have here and would be happy to leave with committee staff over 400 letters from financial aid officers to members of Congress, of which copies were sent to their guarantors. We have as well letters from 16 of the State associations that are members of NASFAA. We simply agree with Ms. Roemer that the aid community is divided, concerned, I think very apprehensive, about the challenge that they will face without adequate support from the Department or even on their own campuses.

I would also note that many colleges do not participate in the Perkins program, as you know. The actual costs of Perkins I believe have been documented to be higher than under the Federal program; the default rate under Perkins is higher. So that to cite the ease of Perkins on some campuses as a model for direct lending really is not intellectually sound, because they are quite different populations and have quite different experiences.

Senator WELLSTONE. Mr. Atwell and Mr. Witten are reaching for the microphone.

Mr. ATWELL. I think the default rate on Perkins and the cost to the Government on Perkins is less than is the case—less per dollar loaned than is the case in the guaranteed student loan programs.

What we have is the opportunity for simplification, the opportunity to deal with some of these servicing issues at the campus level. And I just think we ought to move forward on that basis—and bear in mind when we talk that the higher education community including the aid community is divided on this. That is clear. But I think part of that division reflects misinformation, and when the information gets out there to colleges and universities, and when they see how the Department of Education has responded to their concerns, they are going to feel much more comfortable about it.

Senator WELLSTONE. Mr. Witten.

Mr. Witten. If I understand Ms. Roemer correctly, her comments are addressed to the current system and the difficulties there, as were the students' comments. I would say simply that those comments, both of the students in the previous panel and Ms. Roemer's comments, echo what the commission heard in its hearing across the Nation during its 2 years.

Senator WELLSTONE. Mr. Schullo?

Mr. SCHULLO. Let me give you an example of the Perkins loan program. We have a $700,000 Perkins loan program. Everything approved by the counselors through Thursday noon creates a check, or the direct credit of the student's account by Monday morning at 9:00. On the Stafford loan program, we are talking about 4 weeks.

Senator WELLSTONE. Senator Kassebaum.

Senator KASSEBAUM. Thank you.

Mr. Schullo, and everybody else who has made comments about the difficulties—the servicing and the simplification of the forms and so forth I can only fully appreciate how difficult it must be for a financial aid administrator as we have continually tried to change and improve, hopefully, each time, the process. And I don't know that it has improved that much.

However, I think some of the difficulties are not necessarily going to be improved by going to direct lending. That is where I worry about perhaps a misconception, particularly on the part of students.

I'd like to ask you, Mr. Schullo, because I was struck with the story you told about the young man who had the $30,000 in loans. What would help him, I suppose, would be the income-contingent repayment, not the direct lending——

Mr. SCHULLO. Correct.

Senator KASSEBAUM. [continuing]. That means he could carry it on out through the years—which worries some students, as was expressed earlier, with the interest accruing as it went along. Also it is assumed now, I think, that maybe after 25 years, that loan would be forgiven. So I suppose he could look at it in that it would relieve some of the burden that he feels he might have now in getting it repaid.

Mr. SCHULLO. I agree.

Senator KASSEBAUM. Mr. Atwell.

Mr. ATWELL. I wanted also to say I think something else that Congress can do to address that problem of that particular kind of student is to redress the imbalance between grants and loans that has been created in the past 12 years. That problem is very severe and is not addressed by this legislation, but you have other opportunities to deal with that through the appropriations process.

Senator KASSEBAUM. Yes. I would just say also—because it has been hinted that savings in the direct lending program could be applied to Pell grants and other discretionary programs, that unless we change the rules of the budget process, that could not be. By law, that would be prohibited at this point.

Mr. Atwell, I have received a lot of letters from financial aid officers and college presidents, whom I have talked to a lot in Kansas, and there is great division. It makes it very hard for us to decide. And I had the pleasure of meeting Mr. Witten in Kansas when Wichita State University hosted a meeting of the commission.

Did you poll your organization, the American Council on Education?

Mr. ATWELL. No. We had a discussion of this at our board of directors level, but we didn't poll our membership. I must say I quarrel with the poll that my colleague here referred to as being an objective measure of what the American people really think.

I did acknowledge that the constituency that I serve is divided, and in this instance I think we are taking a bit of a risk in getting out in front of some of them a bit. But as I said earlier, Senator, I think part of that is the misinformation that has been deliberately generated—or disinformation—and part of it is simply a lack of knowledge about what the proposals of the Department really are.

Senator KASSEBAUM. To a certain extent, I would agree, but it works both ways. There has been some misinformation or disinformation, but there has also been a focus on how simple it will all be and the great savings to the students. And I think it is unfair to the students to mislead them to believe this is going to be a big savings to them.

I just feel we have to be realistic about the pluses and minuses of it.

Just one further question or statement to anyone who would wish to comment—and I hate to dwell on the budget, but a lot has been made that this would result in a deficit reduction. There have been differences of opinion as to how much it might be—$3 billion, $4 billion over 5 years. Does it trouble any of you that it is an acknowledged fact that direct lending means a $20 to $25 billion addition to the debt when we go to direct borrowing from the Treasury. Until the loans start to be repaid, that is going to be an addition to the debt. Does that prove troubling to anybody?

Mr. **Atwell**. Yes, that certainly is troubling, but over time, that would be corrected—I think it is the year 2004 by which you begin to get the benefits. The existing system will continue to drive up the national debt as well. So the comparisons there are not entirely fair.

Mr. Witten. And the alternatives, really, are to do nothing or to cut back on loans as you have cut back on grants. I really appreciate the difficulty of the country and the necessity for moving on the budget; I think that is a matter of the utmost national importance. As a trustee of the Vermont State College System, we are experiencing considerable financial difficulties. We have the highest State college tuition in the Nation, and we have resolved that we are not going to get any help from Washington; that in fact, you are going to be unable to send the cavalry in any sense. And we, somehow, will make it, but I think you are going to have to reduce the budget, and you are going to have to, in very difficult times, I think perhaps put aside some reservations and take some risks and to move in areas where every indication is that a savings is available—$4 billion is something I think we can't afford not to.

Senator **Kassebaum**. I would agree, but let me just ask at the risk of sounding very blunt at this point. We are going to essentially end default, because there will be no default now; and we will be providing access, as we do now, to everyone who wishes to take out a loan. But at what point do the colleges have some responsibility for keeping their costs until control? It seems to me that that does play into it.

Mr. Witten. They have a tremendous responsibility, and the lack of grant funds and the cost of the loan funds are in effect, through the forces of the marketplace, going to force every institution in this country to come to terms with that reality. And those that do not do it effectively are not going to make it; there are going to be a lot of belly-up higher education institutions in this country.

Senator **Kassebaum**. Mr. Cheever.

Senator **Wellstone**. I wonder if I could just respond for a moment to two points that Senator Kassebaum made. Figured into this calculation of cost is that the Government now guarantees these loans, so money is put up front; I think that has to be figured into it.

The other point I would want to make is—at the risk of being misunderstood—someone once said "Not all debt is created equal," and my argument is that a lot of the debt that we have built up over the 1980's is now what we are trying to deal with; it had nothing to do with productive investment of any kind.

I do believe that if we were to get serious—and the comments made about the Pell grant program and the imbalance between loans and grants was very dear to my heart, having been a college teacher for 20 years—it does strike me that education and investing in young people—and for that matter, not so young people, because many of the students are now nontraditional students—is clearly an investment which in the short run may cost more, but in the middle run and long run, we will be much better of. I would far prefer—just like any good business will make an investment in the short run that will pay a dividend over and over again, this is an area where I think we really ought to be willing, and I think the direct loan program fits into that—not as a substitute, I might add, for Pell or other loan programs.

Mr. CHEEVER. But here is the real long-term risk. As college costs continue to rise—and colleges are doing a much better job, but we aren't out of the woods yet—and as more students go to college, because elementary and secondary enrollments are rising again, not falling, students will have to borrow more; loan limits will have to be increased; more students will be borrowing more money. The 3 years from now $25 billion annual addition to the Federal debt will grow to $40 billion, or $60 billion, or some day $100 billion.

The long-term risk is what we have with Medicare. Suddenly, the Federal Government realizes that $100 billion a year supporting a direct lending program—and this is described in our proposal—means that it has to ask higher education hard questions about faculty productivity, about costs, about length of semesters, about choice offerings in curricula. I am the trustee of Massachusetts General Hospital, a teaching hospital of Harvard University, and I can tell you what the Federal Government's legitimate concerns to control health care costs have done to the internal workings of a major university and its teaching hospital. It is not a good way to achieve cost control, as witnessed by the President's current activity to reform it.

We face that same long-term risk in higher education, and that's one of my real worries.

Mr. ATWELL. I just want to say that I hope this committee will explore further savings beyond the $4.3 billion and divert some of those savings to helping the students even more. If you could wring some of those excess profits out of the $50 billion of guaranteed loans that are going to be made in the next 5 years irrespective of the direct loan phase-in, and have some of that benefit students, then I think you've got a real winning package.

Senator WELLSTONE. Well, I would argue—and we all make our own arguments here—I would say the health care analogy for me would be the amount of money that gets put into this and the administrative bloat with the role of the insurance industry. I believe that if you had much less of that, for example, you would have more money for direct health care services to people. I believe that's the analogy with the direct loan program——

Senator KASSEBAUM. I agree with you on that.

Senator WELLSTONE. —and Senator Kassebaum agrees with me on that, too, and on that note, we will conclude.

Senator KASSEBAUM. Mr. Chairman, I ask unanimous consent that a National Consumers League's report against direct lending be made a part of the record.

Senator WELLSTONE. Without objection.

[The document referred to and additional material submitted for the record follows:]

May 10, 1993

The President
The White House
Washington, DC

Dear Mr. President:

The National Consumers League, our nation's oldest consumer organization, commends you on your bold approach to providing our youth with an opportunity to serve the public through a national service program. We know of your commitment to assuring that those who want to go to college or receive training beyond secondary school may do so. We too share your belief that this investment in our youth is one well spent and is needed to assure the change that you envision for our nation.

Since our founding in 1899 NCL has had youth as a focus -- assuring that young people's first priority must be education rather than being exploited in the sweatshops. We continue to make that the focus of our work today by encouraging tough enforcement of child labor laws and encouraging our federal government and state legislators to focus on education as the number one job of high school youth.

NCL strongly supported the Great Society program's Higher Education Act in the 1960's which authorized new funding to provide federal scholarships for needy undergraduate students and funds to strengthen colleges. We supported the student loan program, the Teacher Corps Bills, the National Defense Education Act, the Vocational Education Bills and the subsequent reauthorization of those programs. Along with our sister consumer groups, NCL has consistently been critical of the fraud that has sometimes been associated with student loan programs.

Because of our strong commitment to a viable program that affords young people the ability to attend college or receive training, we want to work with you to assure that the restructuring of the program is in the very best interest of our youth. Enclosed is a report that we are releasing today to you and to those members of Congress who will be given the responsibility to reshape the student loan program. I hope that this information is a useful tool in the dialogue arising from this great challenge to our nation. And I again want you to know that we support your commitment to investing in our greatest human resource -- our children.

Sincerely,

LINDA F. GOLODNER
President

LFG:lf

GUARANTEED STUDENT LOANS
A PROGRAM IN NEED OF REPLACEMENT ... OR REPAIR?

OVERVIEW

The Guaranteed Student Loan program was established in 1965 to provide students and their families the financial wherewithal for higher education. The program, enacted as an entitlement to students meeting prescribed criteria, had provided about $142 billion in student loans as of September 30, 1992.[1]

The National Consumers League strongly supported the passage and enactment of the Higher Education Act of 1965 to provide federal scholarships to needy students and funds to strengthen America's colleges. We supported the legislation that created the student loan program, the Teacher Corps, the National Defense Education Act, vocational education bills and the subsequent reauthorizations of those programs. Along with its sister consumer groups, NCL also has consistently been critical of the fraud that sometimes has been associated with the guaranteed student loan program.

In recent years, that program has been the subject of mounting criticism, focused on its cost, complexity and rising default rate. This has led to suggestions for sweeping overhaul, both to enhance its integrity and to reduce the level of federal subsidy.

In the 102nd Congress, calls for reform led to major changes in the student loan program. In making those changes, Congress authorized a demonstration project to test an alternative means of financing student loans. That experiment, which would substitute federal funds for loan funds provided by private lenders, is scheduled to begin in July 1994, involving an estimated 250 to 300 schools. The objective is to test the feasibility of strengthening the federal role in disbursing, administering and collecting student loans and determine whether such an arrangement would, in fact, reduce federal expenditures.

In recent months, revamping the student loan program has acquired a new sense of political urgency, brought on by the outcome of the 1992 election. President Clinton has made it a central element of his plan for national service, a principal theme of his campaign. With deficit and debt reduction a top national priority, the lure of budget savings has cast even greater attention on the issue.

Under the Clinton proposal, loan recipients would be able to retire all or part of their indebtedness by: (1) performing community service, or (2) deducting a specified percentage of their post-education income. The U.S. Department of Education would provide the loans from federal funds and be charged with overall program administration. Colleges and universities would handle processing and disbursement, while the Internal Revenue Service would have a role in collecting loan repayments. The budget resolution passed by Congress in April mandates $4.265 billion in savings from the student loan program over five years, much of it to be gained through enactment of the Clinton plan.[2]

REFORM: WHAT COURSE? AT WHAT COST?

There is little doubt that reform of the loan program is desirable and necessary. A highly skilled, educated work force is crucial to American competitiveness. Yet, more qualified young people than ever find their educational aspirations -- and future ambitions -- hobbled by the challenge of gaining financial access to schools of their choice.

The cost of college continues to rise at an alarming rate. The consequences -- steadily increasing financial pressure on students and families -- are well documented.[3] The Associated Press reported April 5 that cost "has eclipsed location, academic reputation and social life as the No. 1 reason for choosing a college."[4] Even though the current guaranteed loan program delivers an estimated $15 billion a year to approximately 5 million students, or about 17 percent of the undergraduate and graduate students attending colleges, universities, and trade and technical schools,[5] it is not enough. Far too many still find their education and career options restricted by inability to pay.[6]

Student loan reform is crucial to the continued promise of educational opportunity for all Americans, as articulated by President Lyndon Johnson and written into law with enactment of the Higher Education Act of 1965. Though amended 20 times, the central goal of that statute remains as much a national imperative today as it was then: to provide "a final line of financial defense for families and students from all levels of income."[7]

NCL supports both the principle and the reality of universal access to education at reasonable cost. The challenges posed by global competition, technological advances and rapidly evolving economic and societal changes demand a literate and skilled work force. Of special importance is the support and safety net we must provide to lower-income and minority youths. In this day and age, finances must not stand in the way of needed access to institutions of higher learning. We simply cannot afford to allow the vast potential of these individuals go untapped. Yet, that is the risk we face. In that regard, direct lending represents a cause for concern, related to the consequences of replacing the existing program with a new, radically different one. A convincing case for such a change has not been made. In fact, it would likely have results worse than the problems it was supposed to solve.

We should give careful thought, for example, to whether the federal government and its contractors (loan servicers, collection agencies and computer consultants), much less colleges, universities and other educational institutions, are equipped take over functions historically performed by banks, guaranty agencies and secondary markets.

This is no small undertaking. Nor is it one without substantial complications or hazards. NCL questions whether this new arrangement could ever be as efficient as the public-private partnership it would replace. In the worst case, a miscalculation of the ability of the U.S. Department of Education to administer the program could result in loans becoming unavailable to many students.

We also must be extremely sensitive to the financial plight of our neediest students. Logic alone suggests that the difficulties of serving as loan officers for the federal government will be disproportionately greater at less affluent educational institutions with limited resources, such as historically black colleges and universities, as well as public institutions in states facing budget shortfalls. Any school with a large percentage of students depending on federal student loans and grants will face significant hardship.[8] The aid and educational opportunities available to many lower-income and minority students would be endangered.

The demands on a universal direct lending program could well divert financial resources from other aid programs.[9] Many members of the education community already worry about the future of Pell grants. Because of a previous shortfall, the actual amount of money available for those grants is estimated to drop by $100 million next year.[10] Moreover, the maximum individual grant, which was cut last year from $2,400, will remain frozen at $2,300.[11] That pays for less and less as tuition and other charges continue to rise. For too many needy students, this points to a crisis in grant availability that would only worsen with conversion to a total direct government loan program.[12]

A wholesale replacement of the guaranteed student loan program should not be attempted until and unless the problems identified with the proposed alternative -- direct loans -- are thoroughly explored and tested through completion of the Direct Loan

Demonstration Program authorized by Congress.[13] At stake are the educational opportunities of the very individuals the system is designed to serve: millions of current and prospective students at thousands of American colleges and universities.

The League's concerns about a centralized, government-run direct student loan program do not in any way reflect any hesitancy about promoting national and community service. Make no mistake about it: NCL is a firm believer in national service. All Americans -- and especially young people -- should be encouraged to channel their energies into improving their communities. Fortunately, there is no need to restructure the student loan program to do that. The current program can easily be adapted to support national service through loan forgiveness. With only minor legislative changes, a larger-scale national service program can be started in 1993. It can be done more efficiently and at less cost than by saddling the federal government and participating educational institutions with the administrative and financial challenges of direct lending.

STUDENT LOANS: TIME FOR CHANGE?

The current student loan program has been attacked for high default rates, excessive program costs, and inadequate oversight. Unfortunately, its complexity alone can serve as an obstacle to educational opportunity for all too many students. On balance, however, this public-private partnership has developed into a system that works -- not always as well as everyone would like, but well enough to help millions of students make their way through college. For those at lower income levels, it is crucial. More than 95 percent of all students from families earning less than $12,000 a year receive some form of federal aid.[14] In fiscal 1991, the mean family income of dependent Stafford loan recipients was less than $19,000. The mean income of independent Stafford borrowers was less than $12,000.[15]

The guaranteed student loan program is today the primary source of federal student financial assistance. It is the largest component of an aid system that includes loans, grants and work/study assistance. This loan program, which provided 45 percent of all available aid to students in 1991-92,[16] comprises:

- Subsidized Stafford loans, available at low interest to students with demonstrated financial need. The federal government pays the interest on the loan while the borrower is in school, grace or default. For undergraduates, the maximum loan ranges from $2,625 for first-year students to $5,500 for third-year students.
- Unsubsidized Stafford loans, available regardless of need. The student pays interest during the in-school and deferment periods. The annual amount of the loan cannot exceed the limits set for the subsidized Stafford loan.
- Parent Loan for Undergraduate Students (PLUS), available to parents who meet the necessary credit requirement, with an annual limit of $4,000.
- Supplemental Loans for Students, similar to the PLUS program, but available to independent student borrowers. As of July 1, the annual loan limit will be $4,000 for first- and second-year students, $5,000 for third- and fourth-year students and $10,000 for graduate students.

Growth of the program has been dramatic. From roughly $2 billion in fiscal 1978, annual loans grew to almost $8 billion by fiscal 1981 and to $12 billion by 1990. Just how important is this source of assistance? During the 1989-90 academic year, about 16 percent of all undergraduates had Stafford loans. Among undergraduates receiving some form of student aid, approximately 37 percent were using Stafford loans to help pay for their educations, which amounted to more than 25 percent of all aid dollars to undergraduates that year.[17]

Since 1965, more than *$140 billion* in financing has been made available in the form of more than *60 million* individual loans.[18] Some 7,800 lenders and 8,000 educational institutions currently participate.[19]

In 1992, Congress made major changes to expand access to guaranteed loans, keep up with rising tuition costs and improve administration and oversight. These included the creation of the unsubsidized Stafford program, which now makes government-backed financing available to all students, regardless of financial need. As a result:

- Loans were made available to an additional 1.4 million people. Loan volume increased by an estimated $3.7 billion.
- Grant assistance was made available for an additional 1 million students.
- Procedures and paperwork requirements were simplified and standardized, making the process easier for lenders, participating schools and borrowers.
- Audit and program review standards were strengthened, improving the prospects for detecting fraud and abuse.
- Direct oversight of educational institutions was substantially increased.[20]

Despite these improvements, the guaranteed student loan program remains far from perfect. To the extent that the system *does* work, it should be permitted to continue working. To the extent that changes *are* warranted to make the system more effective or efficient, we should consider appropriate, well-targeted solutions that preserve the basic framework and intent of this crucial delivery system and resist rash actions with illusory benefits. NCL believes that Congress should take aim at:

- The number of loan programs. There are too many. The number should be reduced through consolidation to make the program more "user friendly," especially for students and their families.[21]
- The cost of the program. It remains too expensive. Subsidies to lenders and guaranty agencies can be reduced. At the same time, the program still must offer financial incentives for participation. Subsidies must not be cut so low as to keep lenders -- and needed capital -- out of the marketplace.
- Default rates. They remain too high. Losses due to defaults have been excessive. The 1992 amendments to the Higher Education Act provide more flexibility to avoid default through deferment or forbearance. They also improved oversight of educational institutions. However, still more can be done. Income-sensitive or income-contingent repayment plans should be available to those who need them.

Faults notwithstanding, the guaranteed student loan program is too important to be discarded. Its strengths should be preserved and its weaknesses should be corrected. As David W. Breneman, a specialist on the economics of higher education, wrote in May 1991, the guaranteed student loan program "is an easy program to criticize, and probably no one starting from scratch would intentionally design what we have today. Nevertheless, for all its flaws, it is now central to the financing of higher education in this country. The interesting question ... is not whether we can design yet another loan program with ideal characteristics, but whether an already successful program can be rendered even more effective and, at the same time, less costly."[22]

In developing a national health care policy, the administration has underscored the need to work with and through existing institutions in a public-private partnership. We should apply that same principle to student financial aid. NCL believes the correct response to the problems that persist lies in reform, not the wholesale replacement of a system on which so many students rely.

UNANSWERED QUESTIONS ABOUT DIRECT LENDING

Under direct lending, the federal government would substitute federal financing for private capital. The Department of Education and educational institutions would assume all costs and responsibilities now borne by financial institutions, secondary markets and guaranty agencies, including loan origination, servicing, collection and counseling.

Even a phased transition to a fully government-run direct loan program would create disruptions and doubts about the future availability of financial assistance, especially for those in greatest need. As described in additional detail below, it would impose severe new hardships on colleges and universities least able to accommodate them and saddle the federal government with a mountain of new debt. However attractive it may first appear, its virtues break down under closer scrutiny.

For example, NCL questions whether the federal government and schools are suited to perform effectively and efficiently as lenders and guaranty agencies. The current system leverages a minimal investment of tax dollars into a large pool of private loan capital. It delivers $1.00 in loan money for every 27 cents invested by the federal government. Under direct lending, however, it would cost the Treasury approximately $1.30 to deliver that same $1.00 in loan funds.[23]

For their part, most educational institutions have neither the resources nor the expertise to serve as banks. In today's economic environment, most find it challenging enough to continue meeting the demands of their primary calling -- high-quality education -- without being diverted from that mission by serving as branches of the U.S. Treasury.

Under a program where educational institutions serve as loan originators, their added administrative duties would include:

- **Reviewing all loan applications prior to processing to ensure that all data fields are filled out in accordance to Department of Education parameters.**
- **Determining the eligibility of borrowers. This would be done by consulting a central database operated by the Department of Education to determine whether the borrower is in default on a previous loan or owes on a Pell Grant refund.[24]**
- **Securing signatures on promissory notes.**
- **Copying all promissory notes and forwarding originals to the Department of Education or its contractor.**
- **Storing the copied promissory notes.[25]**
- **Drawing down the loan funds from the Department of Education.**
- **Disbursing funds to borrowers in accordance with applicable regulations.**
- **Communicating drawdown amounts back to the Department of Education.**
- **Processing modifications in loan amounts for borrowers who receive unanticipated additional Title IV aid, reduce their academic workloads (resulting in the need for a refund) or withdraw from school.**
- **Maintaining escrow account registers in accordance with specifications set by the Department of Education.**
- **Transmitting escrow account information to the Department of Education.**
- **Responding to Department of Education inquiries about escrow accounts.**
- **Forwarding data on student status to the Department of Education or its contractor for timely conversion to repayment as required.**
- **Reconciling drawdowns with disbursements, refunds, and cancellations on a monthly basis.**

These functions all are inherent elements of direct lending. Some of these functions already are performed by participating educational institutions, though subject to the oversight of lenders and guaranty agencies. Under direct lending, that additional safeguard of lender or guarantor review is eliminated. Some schools would face increased liability for cases where loans were issued to ineligible students or in incorrect amounts because of faulty pre-processing review. The Department of Education also could interrupt the delivery of loan funds to institutions with suspect drawdowns and hold schools accountable for any perceived failure to forward student status confirmations in a timely fashion. In other words, added responsibility exposes schools to increased risk.

The costs of this transfer of responsibility are not insubstantial. It is estimated that as much as $1.5 billion in origination, administrative and start-up costs would be transferred to colleges and universities from lenders and the federal government[26] for the establishment of new computer networks and accounting systems to originate and track lending activity. How will many institutions pay for these higher costs if not reimbursed by the federal government? By passing them on to their consumers -- students and parents -- in the form of higher tuition and fees. Ironically, students then would be forced to borrow additional dollars to pay these higher school costs.

NCL's concerns about the burden of direct lending on educational institutions are just that: concerns. The League recognizes that, in practice, administrative costs actually could prove to be lower than projected by opponents of direct lending. Regardless, the federal government -- and not educational institutions -- should be required to absorb any higher costs of direct lending.

NCL also believes caution is in order because of questions regarding the ability of the Department of Education to administer a full-scale direct lending program handling over $100 billion in federal funds over the first five years.[27] In September 1991, the

General Accounting Office reported that it and other watchdog agencies had identified "substantial accountability problems related to the department's management of The department has a long history of management problems in this area,[28] including:[29]

- Consistently missing statutory deadlines. A case in point: regulations implementing Higher Education Act amendments of 1986 were not published until December 1992 and since have been suspended because of continuing problems.
- Failing to properly monitor the eligibility of participating educational institutions.
- Data management shortcomings. The department lacks the systems or expertise to administer a national direct loan program. The closest parallel is the National Student Loan Data Base, which was authorized in 1986 to provide better information and an improved ability to screen out ineligible borrowers. The system has yet to be implemented. A projected December 1993 implementation date has been judged overly optimistic by the General Accounting Office.

At a minimum, direct lending would require substantial improvement of the department's capabilities. The Congressional Research Service noted that "there is debate over the advisability of actually increasing [the Education Department's] financial management responsibilities, which would occur under direct loans, at a time when its performance of more limited administrative responsibilities has been questioned."[30]

Replacing the current system would require massive investment in new data systems and other resources. It also could require a sizable increase in personnel, in order to assume the responsibilities of an industry that currently employs 50,000 people in the private sector.[31] The costs of these management and personnel improvements would diminish any budget savings anticipated from a changeover to direct lending. School administrators have told congressional investigators that they have little confidence in the department's ability to manage a program of this size and scope.[32]

In its analysis, the Congressional Budget Office noted that educational institutions and the Department of Education would face "significantly greater administrative burdens and responsibilities" -- some that they do not want and others they are incapable of exercising.[33] It is clear from the studies to date that hoped-for budget savings from direct lending are based on a shift of non-reimbursed economic costs onto participating educational institutions.

The evidence therefore suggests that the net savings to be achieved from direct lending have been overstated, if they exist at all. The General Accounting Office estimated $4.8 billion over five years.[34] Yet, when Perry Quick, a former senior economist with the White House Council of Economic Advisers, took into account the 1992 changes to the Higher Education Act, along with "more reasonable assumptions" about costs and interest rates, he concluded direct lending "would generate essentially zero budgetary savings," and even a net loss to the government.[35] The Congressional Research Service concluded: "Direct lending actually could increase budget outlays and reduce national income if it were unable to duplicate administrative cost efficiencies achieved by private lenders."[36] It raised doubts about whether those efficiencies could be achieved and concluded cost savings could be gained from the existing system without heading down the uncertain course of a full conversion to direct government lending.

As a matter of *education* policy, the 1992 changes in the student loan program represented major progress toward a central goal of direct lending proponents: universal financial access to higher education. As a matter of *fiscal* policy, however, direct lending remains an untested proposal with debatable budget savings that so far exist only on paper. Until its benefits are demonstrated, it remains a risk we cannot afford to take.

IMPACTS ON BORROWERS

Worse, perhaps, than turning our colleges into banks and the government into a primary lender is the impact this could have on the individual borrower. In a transition to direct lending, some students who depend on the current system of private primary and secondary lenders would fall through the cracks, due to changes in the *availability*, *accessibility* or *predictability* of financing for higher education:

- Availability. An increased emphasis on financing through loans would divert and decrease resources from other forms of aid, including grants and work/study programs. This would be felt most by lower- and middle-income students.[37]
- Accessibility. Direct lending would affect different colleges and universities to different degrees. In the end, true universal access to loans could be endangered. The United Negro College Fund (UNCF) has called direct lending a burden that its 41 member institutions simply cannot bear. "The fiscal and administrative implications of this undertaking are enormous and potentially disastrous for our students and their institutions," UNCF has said.[38]
- Predictability. Students *must* be assured that assistance promised today will still exist tomorrow. Such assurances would be difficult under a system wholly dependent on government funding, administration and oversight. As DePauw University President Robert G. Bottoms has warned: "Direct lending could place at risk students' access to loan funds. Because the funding for direct loans depends on federal borrowing we see the potential for future problems when, on occasion, politics dictate controversy and delays in approving higher debt ceiling levels."[39]

Termination of the existing program, even on a phased basis, would create significant disruption of currently available financial assistance. Facing a government takeover of their student loan business, lenders might well end their participation in the program early, leaving students without loans. The projected insolvency of up to 18 guaranty agencies during this phase-out stage would create borrower confusion and higher federal guarantee costs. Estimates of those additional costs, which account for only a portion of the total projected program termination costs, soar as high as $1.6 billion.[40]

In short, direct lending carries a high cost to colleges and the government and untold risks to students. As a practical matter, the federal government may be unable to assume an undertaking of this size and scope without burdening consumers with higher taxes, educational institutions with greater administrative demands and students with large new amounts of personal debt. In the end, this places additional upward pressure on the federal budget, federal borrowing and the tuition rates that already create substantial barriers to college applicants.

Given the record to date and the untested nature of these ideas, there is reason to believe a switch to direct lending would not only cost jobs and tax dollars,[41] but also disrupt the educational plans of countless students whose futures could fall through the cracks of a system in transition. Those most vulnerable to its administrative and financial pitfalls may be those with the greatest need -- and greatest potential to succeed.

In any changeover of this magnitude, there will be a period in which borrowers suffer from a shortage of student aid or are forced to contend with chaos. Many students, especially those enrolled in vocational or community college programs, would be left without needed access to loans, disrupting their educational plans. This exposes students to unacceptable levels of uncertainty and risk.

CONCLUSIONS

We all have a stake in guaranteeing universal access to higher education, if only to ensure that our future work force is skilled, literate and able to compete in the global economy. We applaud President Clinton's national service initiative as a bold challenge to America's youth. The League believes the surest, most effective way to achieve both is by building on the experience and expertise of existing institutions and programs. National service can and should be integrated into the student loan program now in place.

Recognizing that the current loan system is flawed, we urge efforts to improve and strengthen it. At the same time, we question its wholesale replacement with an untried, unproven program of direct government lending. We have these specific concerns:

- A government-run loan delivery system would be more vulnerable to logistical and administrative breakdowns that would leave students with no access to funds for extended periods of time.
- Educational institutions should not be asked to assume responsibility for loan origination and other banking functions they are ill equipped to handle. This threatens to create a system of financial haves and have nots.
- The added administrative costs assumed by colleges would be passed on to the ultimate consumer -- the student -- in the form of increased tuition and fees.
- Small colleges, including many serving large enrollments of minority students, would be affected disproportionately because many lack the personnel and resources to deal with loan origination and administration.
- It may not be a reliable source of capital for students. The necessary funds -- estimated to run as much as $25 billion a year -- may not be provided from the Treasury as promised.
- Institutions unwilling or unable to shoulder the added burdens of direct lending would be cut off from a vital source of student financial aid.
- Historical problems in the Department of Education's administration of student aid programs suggest direct lending would lack sufficient oversight and be prone to delays and uncertainties affecting the availability and delivery of loans.

- **Perhaps most importantly, the Department of Education has not explained how it would address loan access problems caused by private lenders leaving the program before a new direct lending system is in place and the insolvencies of up to 18 guaranty agencies that would result from this changeover. Nor has the department estimated the cost to the government and affected institutions.**

The League urges Congress and the administration to proceed with caution and carefully test the alternatives before moving forward with any major renovation of the student loan program. The stakes are simply too high to do otherwise.

SOLUTIONS

NCL believes the current loan program can and should be improved. However, no full-scale transition to direct lending should be attempted until the concept is thoroughly tested and its merits documented. The Direct Loan Demonstration Program should be completed and thoroughly evaluated, with any future decisions in this area based on its results. In the meantime, immediate improvements can be undertaken by:

- **Reining in subsidies to lenders and guaranty agencies without removing the financial incentive for them to participate in the program.** The 1992 amendments to the Higher Education Act cut the interest rate margin by 15 basis points: from 3.25 percentage points to 3.1 percentage points above the 91-day Treasury bill. That can safely be cut even further, perhaps by as much as 50 basis points during in-school years, when loans are easier to service, without jeopardizing loan availability -- assuming that additional non-reimbursed administration functions are not imposed on lenders and guaranty agencies.
- **Cutting down on waste and abuse by improving oversight of lenders, guaranty agencies and educational institutions.** Lenders and guarantors, especially, should share more of the risk. Congress should increase the reimbursement "penalty,"

which reduces the amount of the reimbursement in accordance with a guarantor's default rate. The Department of Education can more closely scrutinize the eligibility and performance of lenders, guarantors and educational institutions.

- **Improving default rates by working on more flexible repayment plans for delinquent or financially distressed borrowers. We can adopt income-sensitive repayment plans that enable the borrower to limit the his or her financial obligations in the early years and even stretch out the lifetime of the loan if necessary, assuming that minimum interest costs are covered.**
- **Further simplifying and standardizing the program to reduce the number of entities -- and bureaucratic obstacles -- with which borrowers are forced to contend. The current program can be restructured into a single loan program, with a single application and a onetime financial need assessment. The 1992 amendments to the Higher Education Act directed the National Advisory Committee on Student Financial Assistance to look into this area. Hopefully, its recommendations will point to ways to further streamline the system with standardized forms and uniform procedures.**
- **Finally, proceeding with the $750 million pilot program authorized by Congress last year to test the theories behind direct lending before substituting them for the experience of the system now in place. If there are substantial savings to be achieved without endangering access to grants and loans, those savings should be pursued. However, we must not gamble on the allure of savings that later turn out to be minimal or, worse yet, non-existent.**

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[1] *FY 1991 Guaranteed Student Loan Programs Data Book: Guaranteed Student Commitments FY 1966 - FY 1991*, U.S. Department of Education, Office of Postsecondary Education, and Loan Volume Update, prepared by the U.S. Department of Education, Student Financial Assistance Programs, Policy and Training Analysis, March 1992.

[2] "Congressional Conferees Modify Student Loan Budget Provisions," by David Kleinbard, Bloomberg Business News, March 31, 1993.

[3] *Making College Affordable Again – Final Report*, published by the National Commission on Responsibilities for Financing Postsecondary Education, February 1993.

[4] "Financial Need Becomes Criteria for Getting Into College," by Jon Marcus, The Associated Press, April 5, 1993.

[5] *Federal Family Education Loans: Issues Relating to a Change to Direct Loans*, CRS Report for Congress, by Charlotte Fraas, specialist in social legislation, Education and Public Welfare Division, March 16, 1993.

[6] *Making College Affordable Again – Final Report*. Based on current trends, the commission predicts that America will face dire economic and social consequences as an ever smaller percentage of students and families find themselves able to afford postsecondary education.

[7] U.S. Senate Committee on Labor and Human Resources, Report 86-673, to accompany H.R. 9567, the Higher Education Act of 1965 (P.L. 89-329), September 1, 1965.

[8] *Historically Black Colleges and Universities, 1976-1990*, prepared by the U.S. Department of Education, Department of Educational Research and Involvement, National Center for Education Statistics, July 1992. NCES 92-640.

[9] For example, appropriations for the additional salaries and expenses needed by the Department of Education to properly administer a direct lending program would compete for funds with the Pell Grant and other non-entitlement education programs.

[10] *Congressional Quarterly*, April 10, 1993.

[11] P.L. 102-325 authorized a maximum Pell Grant of $3,700 for fiscal 1993, $3,900 for fiscal 1994, $4,100 for fiscal 1995, $4,300 for fiscal 1996, and $4,500 for fiscal 1997. However, the actual maximum award was $2,400 in fiscal 1992 and lowered to $2,300 for fiscal 1993 due to funding limitations. For additional information on the funding problems of the Pell Grant program, see: "Clinton Tries to Save Boost for Pell Grants," by Robert Naylor Jr., The Associated Press, April 26, 1993.

[12] Since the mid-1970s, grant aid has dropped precipitously as a percentage of all student financial assistance as college costs soared, creating more and more of a financial burden on students and families. *National Journal* reported on February 6, 1993, that by 1991, it cost an average of $5,320 a year to attend a public college and $12,866 to attend a private college. Students at the low and moderate income levels are receiving progressively less grant aid with less buying power.

[13] The program is addressed in Part D of Title IV of the Higher Education Act of 1965, as amended by P.L. 102-325, the Higher Education Amendments of 1992.

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[14] *The National Postsecondary Student Aid Study: Preliminary Estimates on Student Financial Aid Recipients, 1989 - 1990*, Contractor Report for the U.S. Department of Education, Office of Educational Research and Improvement, National Center for Educational Statistics. DR-NPSAS-1990.

[15] David O'Connor, U.S. Department of Education, Analysis and Forecasting Division, April 19, 1993.

[16] *Trends in Student Aid: 192 - 1992*, update, The College Board, September 1992.

[17] *FY 1991 Guaranteed Student Loan Programs Data Book*, U.S. Department of Education, 1992.

[18] *Loan Volume Update*, prepared by the U.S. Department of Education, Student Financial Assistance Programs, Policy Training and Analysis, March 1992.

[19] *FY 1991 Guaranteed Student Loan Programs Data Book*.

[20] As described by Rep. William D. Ford, D-Mich., chairman of the House Committee on Education and Labor, in a news release dated July 8, 1992.

[21] *Student Aid Program Simplification Study, Sources of Complexity: Preliminary Findings*, Advisory Committee on Student Financial Assistance, January 1993.

[22] *Guaranteed Student Loans: Great Success or Dismal Failure?* by David W. Breneman, Harvard University Graduate School of Education, May 1991.

[23] *Maintaining the Public-Private Partnership in Education Loan Financing*, Education Finance Council, February 1993.

[24] This database will not show whether the borrower has exceeded statutory loan limits for the current year or over time.

[25] These and all other loan documentation must be maintained for five years under the Direct Loan Program regulation NPRM, published April 2, 1993.

[26] *An Assessment of the True Economic Costs of Direct Loans*, an analysis by the Student Loan Marketing Association, April 1993.

[27] *Guaranteed Student Loans*, High-Risk Series, General Accounting Office, December 1992. GAO/HRD-93-2.

[28] *Student Loans: Direct Loans Could Save Money and Simplify Program Administration*, General Accounting Office, September 1991. GAO/HRD-91-144BR.

[29] See *Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement*, General Accounting Office, March 1993. GAO/AFMD-93-20.

[30] *Federal Family Education Loans: Reduced Costs, Direct Lending and National Income*, CRS Report for Congress, by Barbara Miles, specialist in housing, and Dennis Zimmerman, specialist in public finance, Economics Division, February 22, 1993. 93-241E.

[31] *Federal Family Education Loans: Issues Relating to a Change to Direct Loans*.

[32] *Student Loans: Direct Loans Could Save Billions in First 5 Years with Proper Implementation*, General Accounting Office, November 1992. GAO/HRD-93-27.

[33] *Reducing the Deficit: Spending and Revenue Options*, Congressional Budget Office, February 1993.

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[34] *Student Loans: Direct Loans Could Save Billions in First Five Years with Proper Implementation.*

[35] *Direct Government Lending: The Bottom Line*, by Perry D. Quick, national director of tax analysis and economics, Ernst & Young, Spring 1993.

[36] *Federal Family Education Loans: Reduced Costs, Direct Lending and National Income.*

[37] Though direct lending would not *directly* lead to reductions in grants, the competition for Department of Education non-entitlement funds -- pitting the additional salaries and expenses required by the direct lending program against money for college work\study and Pell grants -- could well have this end result. Moreover, proposals for income-contingent loan repayment could undermine the policy rationale for grant assistance.

[38] UNCF letter to House Education and Labor Committee Chairman William D. Ford (D-Mich.), dated October 22, 1991.

[39] Letter to members of Congress, dated March 16, 1993, and co-signed by the presidents of 21 other private colleges and universities in the Midwest.

[40] KPMG Peat Marwick, in a letter to House Education and Labor Committee Chairman William D. Ford (D-Mich.), dated December 7, 1992.

[41] On February 16, 1993, the inspector general of the Department of Education told the House subcommittee on Labor, HHS and Education appropriations that administration of the direct loan program would require "a large increase in expenditures."

UNDERSTANDING DIRECT LENDING

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JUNE 2, 1993

Introduction

One of the most controversial debates with respect to the financing of higher education continues to be whether the federal government should move from a guarantee student loan program to a direct loan program. Unfortunately, this debate began before there was a basic understanding of direct lending, much less a careful review. As a result of misinformation, the myths and misconceptions of direct lending abound. My purpose is simply to explain how a direct loan program would work.

Defining Direct Lending

The word direct is both an adjective and a verb. As an adjective, some of the definitions of direct from the Houghton Mifflin Company's 1985 edition of the American Heritage Dictionary include:

- proceeding or lying in a straight course or line
- straightforward and candid in manner
- without intervening persons, conditions, or agencies
- lacking compromising or mitigating elements

As a verb, some of the definitions of direct include:

- to conduct or regulate the affairs of; manage
- to take charge of with authority; control
- to address (a communication, for example) to a destination
- to supervise the performance of

I will come back to the definition of direct later.

Semantics is also essential in uncovering the root of the most prevalent misconception about direct lending, that is, that the school is the lender. To lend means to provide (money) temporarily on the condition that the amount borrowed be returned, usually with an interest fee. Under direct lending the funds are lent by, and repaid to, the federal government.

The federal government, not the school, is the lender under direct lending. The school is merely the conduit through which the funds are originated. But the school is not the conduit through which the funds are repaid.

Once one masters this basic notion of "Who is the lender?", many of the myths about direct lending - especially concerning the potential administrative burden and liability for institutions - are easily dispelled.

Conceptual Principles of Direct Lending

Direct lending embodies the concepts of **direct financing, direct delivery, and direct communication.**

Direct financing means that capital is secured through the sale of securities by the federal government. This is the same way funding for the Student Loan Marketing Association (Sallie Mae) was provided until 1981. That system worked well, and Sallie Mae is presently making payments on about $4.8B it still holds.

Direct delivery means that the federal government delivers the proceeds of the loan directly to the student through the school. The student repays the loan directly to the federal government through private sector servicers or the Treasury Department.

Direct communication within the context of direct lending means that the network for the exchange of verbal, written, or electronic transmissions is simple, understandable, and easily accessible. This network for sending and receiving information must support the mission of direct lending, which is to facilitate the origination and repayment of funds.

The philosophical and public policy underpinnings of direct lending have a long history. Direct financing was used in the 1970's to fund Sallie Mae.

Direct delivery of loan proceeds dates back to 1958 and the creation of the National Defense Student Loan, now the Perkins Loan program. It is no coincidence that at one time this loan program was named the National Direct Student Loan Program.

Direct communication is proven to be the best means of transmitting information. If you ever doubt this, just remember the game of telephone where the message communicated in the beginning of the process is very different from that received at the end.

How Direct Lending Works

In order to comprehend how direct lending works, it is important to understand the similarities and differences of direct lending with the Guaranteed Student Loan program, the Perkins Loan program, and the Pell Grant program.

Some of the most adamant critics of direct lending are those that make erroneous assumptions about the program and how it will operate. One incorrect assumption is that direct lending is the Guaranteed Student Loan program with the school as the lender - that is, something akin to the previous Federally Insured Student Loan program. As mentioned earlier, the federal government, not the school, is the lender under direct lending.

In concept, direct lending is the same as the Guaranteed Student Loan program because it is an entitlement program with no limit on the amount of capital. Capital availability is determined by student and/or parent eligibility only. Eligibility for subsidy is based on financial need.

Unlike the Guaranteed Student loan program, the capital is secured from one source at wholesale, rather than retail rates. The program is financed through the sale of government securities, not through commercial lenders. Government subsidies are targeted to students, not to the administrative bureaucracies required to support the program. The direct loan process is transparent to the student.

In implementation and administration, direct lending operates as a hybrid of the Pell Grant and Perkins Loan programs. One way to describe a direct loan program is to say it is the Pell Grant program with a promissory note.

Direct lending employs the Pell Grant electronic infrastructure for application, draw-down of funds, disbursement, reporting, and reconciliation. The majority of institutions in the Pell Grant program are currently making use of these available innovations.

The only requirement in direct lending that is not part of the Pell Grant process is that the school must secure the student's properly endorsed signature on a standardized promissory note. However, this is not a new requirement of institutions, since this is an essential component of the Perkins Loan program. The Perkins Loan program was developed almost a decade before the Guaranteed Student Loan program and has operated successfully for thirty-five years. Almost half the institutions in the current Guaranteed Student Loan program are also in the Perkins Loan program. This includes four-year, as well as two-year, public and private institutions of all sizes - large and small.

Ten Basic Steps to Apply for and Receive a Direct Loan

From the perspective of the student and the institution, there are only ten steps that need to be performed before and during school in order for the student to apply for, and if eligible, receive a direct loan.

Please note that steps one through four are the identical first four steps that all students must perform in order to apply and receive any form of Title IV aid. Therefore, these are not additional steps for direct loan recipients.

Step 1	A student completes the Free Application for Federal Student Aid (FAFSA) to apply for all forms of Title IV Aid and submits it to a processor. There is no additional application for a direct loan.
Step 2	The processor computes a student's eligibility according to the federal need analysis and conducts central data base matches.
Step 3	The school receives an electronic report from the processor.
Step 4	The school determines the student's eligibility for all Title IV aid and sends the student an award notice.
Step 5	The school secures the student's signature on the standardized promissory note and ensures that the note is properly executed.
Step 6	The school draws down the funds from the Department of Education's Payment Management System and posts the funds to the student's account within time frames consistent with existing procedures.
Step 7	The school conducts entrance loan interviews with new borrowers only.
Step 8	The school transmits the promissory note and disbursement

information to the Department of Education's servicing contractor.

Step 9 The school performs reconciliation with the servicer.

Step 10 The school performs exit loan interviews for all borrowers graduating or withdrawing from school.

The Ideal Student Loan Program

During the past year, many federal legislators, educational associations, and educational institutions have concluded that revising the current GSL program will not address the breadth and depth of the program's systemic problems. This conclusion has the support of the General Accounting Office (GAO), which recently identified 17 federal program areas, including GSL, as "high-risk". In its December 1992 high-risk series publication on Guaranteed Student Loans, the GAO refers to the GSL program, recently renamed the Federal Family Education Loan Program as "a complicated, cumbersome process" whose "program structure is flawed".

The next logical progression is to restructure this federal loan program, which is what direct lending does. However, a direct loan program does not need to be a pilot, a demonstration, or a study.

We do not need a demonstration program to prove that direct loans will result in considerable savings. Responsible analysts in the Congressional Budget Office, the General Accounting Office, and the Department of Education have told us so.

We do not need a demonstration program to know that direct loans will better serve borrowers. Confused and often desperate students and their families are telling us now that they need a simple and understandable program.

We do not need a demonstration program at all, which is why in February President Clinton announced his goal of full implementation of direct lending over a phase-in period.

With these thoughts in mind, I would like to share my view of the ideal student loan program. The ideal student loan program serves the needs of the borrowers for whom it is intended, results in the most effective expenditure of the lender's funds, and provides reasonable assurances that the funds will be repaid. The benchmarks I have identified for the ideal student loan program can be summarized as follows.

The ideal student loan program:

- provides assurance for capital demands
- is equitably available for all potential, and eligible, borrowers
- keeps administrative costs to a minimum
- results in timely delivery of the loan proceeds
- is administratively manageable and effective
- has beneficial terms for the borrower
- is understandable to the borrower
- is responsive to the needs of the borrower
- protects the rights of the lender
- ensures program accountability and integrity

Conclusion

If we continue on our present course with the Guaranteed Student Loan program, we will end up spending more money to make loans to fewer students. To bring escalating default costs under control, Congress and the Department of Education will continue to micro-manage the program, resulting in little or no possibility of performance bonuses for entities administering the program effectively.

I agree that we could improve the current GSL program structure by standardizing policies, procedures, and forms, and by making better and common use of new technologies. But to date, lenders, guarantee agencies, secondary markets, and servicers have failed to do this on their own initiative. I believe that the centralization that occurs under direct lending - which is the same as that under the Perkins Loan program - will lead to a faster and smoother transition to this standardization.

There are many myths about direct lending. I would like to dispel two other myths that I have not addressed.

- the myth that direct loans would lead to fraud and abuse by institutions

- the myth that the Department of Education cannot run the program

Again, according to the American Heritage Dictionary, the definitions of to direct which I cited include: to manage, take charge with authority, control, and supervise performance. The current configuration of the GSL program with its multitude of players does not allow the Department of Education to direct the program.

We are all aware that fraud and abuse in the existing loan system are not confined to a few organizations. Without 7,800 lenders, 46 guarantee agencies, and 35 secondary markets to oversee, the Department of Education will be able to focus its efforts on supervising the remaining players - 7,500 institutions and a very small pool of private sector contractors.

In addition, the Department would have the opportunity, if they elect to do so, to develop standardized systems for servicing and collecting loans and to link these systems to existing systems.

To simplify the current loan delivery system, our new approach to federal loans must be based on direct financing, direct delivery, and direct communication. If we do this, everything else falls into place. It's as simple as that. Building on these three essential components, the Department of Education will take the financial, human, and technological resources available to it today and manage an effective direct loan program.

With a July 1, 1994 start date for direct lending and a gradual phase-in plan, it is possible to replace the current guarantee student loan system with direct lending without disrupting the flow of dollars to students.

Finally, should Congress act on President Clinton's planned initiatives of loan repayment based on income contingency and/or national service, it becomes absolutely imperative to have direct lending for two reasons - cost and simplicity. The savings direct lending generates will be needed to pay for these innovations. Without the simplicity direct lending provides at the front-end, it will be impossible to administer the intended range of repayment options involving new entities.

May 25, 1993

The Honorable J. James Exon
United States Senate
SH-528
Washington, D.C. 20510

Dear Senator Exon:

As you know, the Senate Labor and Human Resources Committee will hold a hearing on Wednesday, May 26, on legislation (S 920) which would transfer the delivery and administration of student loans from private lending institutions to the federal government. I have grave concerns with respect to this proposal, and I would like to take this opportunity to share them with you, and also to ask that you request the Chairman of the Senate Labor and Human Resources Committee, Senator Edward Kennedy, to make this letter a part of the hearing record on behalf of the State of Nebraska.

First of all, there is a preliminary issue which must be raised prior to any discussion of the merits of the proposed Federal Direct Student Loan legislation, and that is whether the proposal contained in S 920, as currently structured, is in fact a loan program as opposed to a scholarship or grant program. As you know, the existing student aid program is based upon loans provided to students, and as such it should be reviewed on the basis of its financial cost and rate of return criteria. While it appears that the new proposal may shift the emphasis of student aid away from a loan program to something which is partly a loan program and partly a grant program, it is not clear what the primary thrust would be. This perception is reinforced by the fact that the Federal Direct Student Loan Program Amendments of 1993 are in one bill, while the National Service Proposal is in another separate piece of legislation.

In addition, the proposal calls for a system of income-contingent loans, but the new program would not be fully implemented until the year 2000. Any new program of income-contingent loans could easily be administered through the existing student loan program by the financial institutions involved, with implementation as early as next year. I believe that these inconsistencies need to be clarified to avoid what may be contradictory or mutually unattainable goals.

The most important criterion applied in reviewing the direct student loan program must be the service to students. The current program, which in our state is highly competitive, has attained high standards of service. It is not clear that these standards can be maintained under the direct student loan proposal.

A second important issue to be considered is the certainty of funding for the program. In Nebraska, funding for the existing program is certain, and there have been very few, if any, problems in the funding for student loans over the years that the program has been in existence. The direct student loan proposal, on the other hand, would require borrowing by the federal government and raising the federal debt ceiling. As you know, on a number of occasions in the past, the action required to raise the federal debt has not occurred in a timely manner. If loan funds are not available, our higher education institutions, and most likely the state as well, will be faced with addressing significant cash flow problems, if not in fact actual budget shortfalls.

A third consideration has to be administrative costs. Since the direct student loan proposal requires institutions to take on a significant portion of the banking functions associated with these loans, including the administration and servicing of the loans and reporting to the U.S. Department of Education, there will be significant additional costs to the institutions and to the State of Nebraska to implement and operate this new program. Obviously, those additional costs will ultimately be passed on to the students and the taxpayers of Nebraska. It appears that after full implementation of the Federal Direct Student Loan Program, the projected $4.2 billion in savings to the federal budget will in fact be transferred to the state level and to the institutions, and students and the general taxpayer will be paying more than the $4.2 billion, but simply in a different manner.

It is estimated that the new program would cost the State of Nebraska and its institutions of higher learning at least $1.3 to $2 million per year which may have to be funded from approximately $16.2 million in general fund and property tax support for scholarships for all postsecondary education. That would be a loss of 8-12 per cent of funds available for assisting students of higher education in Nebraska.

It is further estimated that the State would be required to pick up 50-75 per cent of that increase directly. While that amount may not seem excessive, it is a serious drain on the resources of our sparsely populated state. For example, at a minimum, that extra cost to the state would amount to two years of matching funds for the Experimental Program to Stimulate Competitive Research (EPSCoR) initiative at the University of Nebraska.

Furthermore, even if institutions are allowed to contract for some of these banking and administrative services, it is my understanding that the Department of Education will designate the contractor or contractors and there will be no competition. Without competition our experience is that costs will only increase and standards of service will decline.

I believe that a more reasonable approach is to continue with the current demonstration or pilot project as authorized by the Congress in 1992, as opposed to cancelling it. This pilot project would involve only 250 institutions nationwide and would allow for a real world test of the proposed program so that administrative problems, financial impacts, and service standards impacts could be identified by the Department of Education, institutions of higher education, and the states. It does not seem prudent to me to cancel the pilot project without having a better grasp of the impact on those who depend upon the system.

Thank you very much for taking these thoughts into consideration, and thank you for forwarding these comments to the Labor and Human Resources Committee.

Sincerely,

Ben Nelson

E. Benjamin Nelson
GOVERNOR

Senator WELLSTONE. We thank you all.

This hearing is concluded.

[Whereupon, at 2:20 p.m., the committee was adjourned.]

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ISBN 0-16-041465-2
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